pany's preferred stock at its par value of One Hundred Dollars ($100.00) per share.

(2) Petitioner received 533.715 shares of the Company's preferred stock at its par value as his share of the dividend.

(3) Every other common stockholder of the Company besides petitioner received the same pro rata distribution of preferred stock as did petitioner.

(4) The dividend was payable solely in preferred stock of the company, and no stockholder had any election, option, or right to receive anything except such preferred stock in payment of the dividend; there was no representation by the Company to any stockholder at any time that any part of the dividend shares would ever be redeemed in cash.

(5) Petitioner sold his shares of dividend stock to the Company about three months after the distribution for Fifty-three Thousand Three Hundred Seventy-one and 50/100 Dollars ($53.371.50), this amount being the par value of the dividend shares received, without the redemption premiums of $5.00 per share provided for by the Company's articles of incorporation in case of actual redemption by the Company.

(6) At the time petitioner sold his dividend stock to the company, neither he nor any other stockholder had any contract right to receive any sum of money from the Company in exchange for the dividend shares.

(7) The stock distributed in the dividend of July 1, 1929, was not all sold to the Company by the owners thereof after said date. There was no purchase or redemption of the dividend stock pro rata from all the stockholders.

(8) The purpose of the Company in purchasing petitioner's dividend stock was primarily to secure additional preferred stock for sale to its employes, and not to effect a distribution of cash to petitioner.

(9) The transaction here described was not in any sense a redemption of its preferred stock by the company.

Wherefore, the petitioner prays that this Board may hear the proceeding and review and reverse the findings of the Commissioner of Internal Revenue complained of above and set aside the Commissioner's determination of deficiency as set forth in his notice of deficiency dated October 19, 1931, and grant the petitioner such other and further relief as he may be entitled to in the premises.

H. C. Gowran,
H. C. Gowran,
2403 Washington Street, Two Rivers, Wisconsin.
A. L. Nash,
Attorney for Petitioner,
Post Office Address:
Manitowoc Savings Bank Bldg., Manitowoc, Wisconsin.

[*Duly sworn to by H. C. Gowran, jurat omitted in printing.*]

6 *Exhibit A to petition*

TREASURY DEPARTMENT,
Washington, Oct. 19, 1931.

Mr. H. C. GOWRAN,
2403 Jefferson Street, Two Rivers, Wisconsin.

SIR: You are advised that the determination of your tax liability for the year(s) 1929 discloses a deficiency of $5,831.67, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, If You Do Not Desire To Petition, you are requested to execute the inclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return(s) by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; Whereas If No Agreement Is Filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNETT,
Commissioner.
By J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement.
Form 882.
Form 870.

7 STATEMENT

IT:AR:D-2
MR-60D
In re: Mr. H. C. GOWRAN,
2403 Jefferson Street, Two Rivers, Wisconsin.

TAX LIABILITY

Year 1929; Tax Liability $14,686.91; Tax Assessed $8,855.24; Deficiency $5,831.67.

Reference is made to the report of the internal revenue agent in charge and to your protest dated March 24, 1931.

Careful consideration has been given the information furnished in your protest and also during the conference held in this office on August 7, 1931 with your representative, Mr. A. L. Nash.

The facts indicate that on July 1, 1929, the Hamilton Manufacturing Company, distributed to you a stock dividend of 533.715 shares paid in preferred stock of the company and that each share had a par value of $100.00. The facts further indicate that you returned this stock to the company on October 1, 1929 and received therefor $100.00 per share in cash.

Section 115 (g) of the Revenue Act of 1928 provides:

"If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend."

Article 629 of Regulations 74 provides that the question of whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case.

The information indicates that the redemption of stock by the corporation is essentially equivalent to the distribution of a
8 taxable dividend. Your contention that the dividend of July 1, 1929, payable in preferred stock was purely a stock dividend has accordingly been denied.

Ordinary net income reported		$49,728.53
Capital net gain		47,161.62
Total net income reported		$96,890.15
Add:		
1. Increase in dividends		53,371.50
Total		$150,261.65
Deduct:		
2. Profit on Hamilton Manufacturing Company preferred stock eliminated	$445.47	
3. Decrease in capital net gain	27,262.72	27,708.19
Net income as adjusted		$122,553.46

COMPUTATION OF TAX

Total net income adjusted		$122,553.46
Less:		
Capital net gain included		19,898.90
Ordinary net income adjusted		$102,654.56
Less:		
Dividends	$94,331.50	
Personal exemption and credit for dependents	3,500.00	97,831.50
Net income subject to normal tax		$4,823.06
Normal tax at ½% on $4,000.00		20.00
Normal tax at 2% on $823.06		16.46
Surtax on $102,654.56		12,190.91
Tax at 12½% on $19,898.90		2,487.36
Total		$14,714.73

Brought forward		$14,714.73
Less:		
Earned income credit	$20.62	
Tax paid at source	7.20	27.82
Tax liability		$14,686.91
Tax previously assessed		8,855.24
Deficiency		$5,831.67

COMPUTATION OF EARNED INCOME CREDIT

Earned net income	$14,300.00
Less:	
Personal exemption and credit for dependents	3,500.00
Income subject to normal tax	$10,800.00
Normal tax at ½% on $4,000.00	20.00
Normal tax at 2% on $4,000.00	80.00
Normal tax at 4% on $2,800.00	112.00
Surtax on $14,300.00	46.00
Total tax	$258.00
Credit of 25% (limited to 25% of normal tax on ordinary net income, plus 25% of surtax on earned net income)	$20.62

EXPLANATION OF CHANGES

1. The amount realized on the redemption of 553.715 shares of Hamilton Manufacturing Company preferred stock is held to be essentially equivalent to a taxable dividend as explained in the foregoing statements.

2. Profits on sale of securities, etc., has been decreased by the profit realized on the redemption of Hamilton Manufacturing Company preferred stock.

3. Profit realized on the redemption of Hamilton Manufacturing Company preferred stock has been eliminated from capital net gain.

A copy of this letter is being forwarded to Mr. A. L. Nash in accordance with the authority conferred upon him in the power of attorney executed by you and now on file in this office.

10 Before United States Board of Tax Appeals

(Caption—60890)

Answer

Filed Feb. 5, 1932

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1, 2, and 3. Admits the allegations contained in paragraphs 1, 2, and 3 of the petition.

4. Denies error in the action recited in paragraph 4 of the petition.

5. Denies each and every allegation of fact contained in subparagraphs (1) to (9) inclusive, of paragraph 5 of the petition which is

inconsistent with and contrary to the determination of the Commissioner as stated in the notice of final determination of a deficiency dated October 19, 1931.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Board redetermine the amount of the deficiency involved in this proceeding to be equal to the amount determined by the Commissioner, plus any additional amount which may arise from the correction of any error or errors that may have been committed by the Commissioner. Claim is hereby asserted for the increased deficiency, if any, resulting from such determination.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
BERNARD D. HATHCOCK,
Special Attorney, Bureau of Internal Revenue.
reb. 1-26-32.

11 Before United States Board of Tax Appeals

(Docket No. 60890)

H. C. GOWRAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(Docket No. 60891)

EDITH ROSE SUDDARD, AS EXECUTRIX OF THE ESTATE OF THOMES W. SUDDARD, DECEASED, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(Docket No. 60892)

GEORGE S. HAMILTON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(Docket No. 60893)

EDWARD P. HAMILTON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Stipulation of facts

Filed at Hearing July 26, 1932

Subject to the right to offer other and further testimony not inconsistent herewith, the parties to the above styled proceedings, by their

respective attorneys of record, hereby stipulate and agree that the following facts are true:

(1) Hamilton Manufacturing Company (hereinafter referred to as the company) is a corporation organized under the laws of Wisconsin on February 23, 1926, having its principal office and place of business at the City of Two Rivers, Wisconsin. Article III of its "Articles of Organization" is as follows:

"The capital stock of said corporation shall be divided into shares, and shall consist of preferred stock with par value and of common stock without par value, as follows:

Ten thousand (10,000) shares of said stock, with a par
12 value of One Hundred Dollars ($100) per share, aggregating One Million Dollars ($1,000,000.00), shall be preferred stock and bear a preferential cumulative dividend payable out of the net profits of the corporation at the rate of seven per cent. (7%) per annum before any dividends shall be paid upon the common stock; and fifteen thousand (15,000) shares of said stock shall be common stock without any nominal or par value, and every share of such common stock without nominal or par value shall be equal to every other share of such common stock.

The holders of shares of said common stock without nominal or par value shall be entitled to all the rights and powers with relation to said stock, and with relation to their right to vote in stockholders' meetings and with relation to choosing directors, which are conferred on stockholders by law and by these Articles of Organization and by the By-Laws of the corporation; and wherever by these Articles of Organization rights and privileges are granted to stockholders or restrictions or limitations are placed upon stockholders, it is hereby declared that only the holders of the common stock are meant unless specifically designated otherwise.

The common stock without nominal or par value may be issued by the corporation from time to time, for such consideration as may be fixed from time to time by the Board of Directors thereof.

Dividends at the rate of seven per cent (7%) per annum may be paid by the corporation on its outstanding preferred stock, if the net profits of the corporation shall be sufficient therefor, and may be paid, at the option of the directors, semi-annually or quarterly. The common stock shall not receive dividends for any year unless seven per cent. (7%) shall first be paid for that year on the par value of all the preferred stock then outstanding together with all arrears of dividends on preferred stock at the like rate for previous years; but when seven per cent. (7%) shall have been paid for any year upon the par value of such preferred stock, together with all arrears of dividends at the like rate for previous years, the residue of the net profits of the corporation may then be distributed as dividends ratably to the holders of the common stock. Dividends on either preferred or common stock shall in no case be paid out of corporate assets not accruing from profits.

Upon the liquidation or dissolution or winding up of said corporation (whether voluntary or involuntary) the pre-
13 ferred stock shall be entitled to receive out of the assets of the corporation in money or in money's worth the face or par value of the preferred stock then issued and outstanding, and no more; but if upon such liquidation, dissolution or winding up, the corporation shall have, after payment of all its debts and obligations, assets which have accrued from profits the preferred stock shall be entitled to receive out of assets which have accrued from profits (but not out of other assets) payment of all of the seven per cent. (7%) annual dividends which may then be in arrears but no more. Thereafter the residue of the funds and assets of the corporation shall be divided equally among the shares of common stock then issued and outstanding.

The corporation shall have the right to purchase and redeem any part or all of said preferred stock on January first or July first in any year, by paying for each share of such preferred stock the sum of One Hundred Two and 50/100 Dollars ($102.50) together with all accrued or accruing dividends thereon computed to the date of such redemption; but as a condition of the corporation's right to redeem, it shall give written notice of its intention to so redeem to the holder or holders of such stock, at least thirty (30) days prior to the date fixed by the corporation for such redemption. Said preferred stock, when so redeemed by the corporation, shall be cancelled, but may be again sold and new certificates therefor issued."

The holders of preferred stock in said corporation shall have no vote in the meetings of its stockholders nor in choosing directors nor otherwise in the management of the corporation.

All certificates evidencing issues of either preferred stock or common stock of the corporation shall bear on the face thereof a statement of all privileges accorded to and all restrictions imposed on the preferred stock of the corporation.

The corporation may fix a fiscal year by By-Law, which may or may not be identical with the calendar year; and all computations of profits for the purpose of determining whether or not dividends are payable, and to what amount, shall be made upon the profits of each recurring fiscal year if a fiscal year shall be fixed as herein provided, otherwise upon profits of each recurring calendar year."

On April 5, 1926, the seventh paragraph of Article III of the "Articles of Organization" was amended to read as follows:

"The corporation shall have the right to purchase and re-
14 deem any part or all of said preferred stock on January first or July first in any year, by paying for each share of such preferred stock the sum of One Hundred Five Dollars ($105.00), together with all accrued or accruing dividends thereon computed to the date of such redemption; but as a condition of the corporation's right to redeem, it shall give written notice of its intention

to so redeem to the holder or holders of such stock, at least thirty (30) days prior to the date fixed by the corporation for such redemption. Said preferred stock when so redeemed by the corporation, shall be canceled, but may be again sold and new certificates therefor issued."

On December 27, 1928, Article III of the "Articles of Organization" was further amended by striking out the first two paragraphs thereof and inserting in their stead the following two paragraphs:

"The capital stock of said corporation shall be divided into shares, and shall consist of preferred stock with par value and of common stock without par value, as follows:

Ten thousand (10,000) shares of said stock, with a par value of One Hundred Dollars ($100) per share, aggregating One Million Dollars ($1,000,000.00), shall be preferred stock and bear a preferential cumulative dividend payable out of the net profits of the corporation at the rate of seven per cent. (7%) per annum before any dividends shall be paid upon the common stock; and thirty thousand (30,000) shares of said stock shall be common stock without any nominal or par value, and every share of such common stock without nominal or par value shall be equal to every other share of such common stock."

(2) On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by thirty individuals in amounts ranging from 1 share to 6189 shares, the petitioners' holdings thereof being as follows:

H. C. Gowran	3812.25 shares.
Thomas W. Suddard	2833.8 shares.
George S. Hamilton	6189 shares.
Edward P. Hamilton	1619.25 shares.

The four petitioners were holders of common stock of the company throughout the year 1929.

(3) On and up to July 1, 1929, the company's preferred stock, issued and outstanding, amounted to 7,155 shares, held by approximately 300 individual stockholders, the petitioners holding no shares of preferred capital stock prior to July 1, 1929.

15 (4) On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05.

(5) At a special meeting of the Board of Directors of the company held on June 29, 1929, the following transpired:

"On this date at eleven o'clock A. M. the Board of Directors of Hamilton Manufacturing Company, convened pursuant to consent of all directors.

"Director E. P. Hamilton duly offered the following resolution and upon motion made and seconded, it was unanimously adopted by the Board:

"Whereas, on the date of this special meeting of the Board of Directors of Hamilton Manufacturing Company, to-wit: June 29, 1929, the surplus of the company is in excess of $261,531.20; and

"Whereas, the company can at the present time lawfully declare and distribute a dividend to the holders of its common capital stock, in the sum of $261,531.20; and

"Whereas, the outstanding common capital stock of the company on this date is 18,680.8 shares, and a dividend of $14.00 per share on all of said common capital stock would amount in all to $261,531.20; and

"Whereas, of the authorized preferred stock of the company, amounting to 10,000 shares at $100.00 per share, or $1,000,000.00 in all, there remain unissued 2,616 shares or more, having a par value of $261,600.00, which unissued shares of preferred stock are available for issue by way of a stock dividend; and

"Whereas, it is for the best interests of the company and its stockholders that a dividend of $14.00 per share be declared and paid at this time on all of the issued and outstanding common capital stock of the company, the same to be paid, however, in the preferred stock of the company, computed at the par value thereof, viz: $100.00 per share; now therefore

"Resolved, by the Board of Directors of Hamilton Manufacturing Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz: $100.00.

16 "Resolved Further, that in distributing the stock dividend hereby declared, no fractional shares of preferred stock be made use of, and that the treasurer of the company be, and he hereby is, directed to adjust with each stockholder, by cash payments (from the stockholder to the company, or from the company to the stockholder, as the case may be), any fractional share by which the company has overpaid or underpaid such stockholder.

"There being no further business to come before the Board of Directors, the meeting was adjourned sine die.

"THOS. W. SUDDARD, *Secretary.*

"Attest:
"J. E. HAMILTON,
"H. C. GOWRAN,
"GEO. S. HAMILTON,
"THOS. W. SUDDARD,
"E. P. HAMILTON,
"Directors."

(6) Pursuant to the foregoing resolution, a stock dividend was paid in shares of the company's preferred stock of the par value of $100.00 per share.

(7) Said stock dividend amounted to $14.00 on every share of common stock then outstanding, or $261,531.20 in all (18,680.8 x $14.00); and the same was paid to common stockholders by the distribution to them on July 1, 1929, of 2,615,312 shares of the company's preferred stock.

(8) H. C. Gowran, the owner of 3,812.25 shares of common stock, was entitled to, and did receive 533,715 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(9) Thomas W. Suddard (now represented by Edith Rose Suddard, Executrix), the owner of 2,833.8 shares of common stock, was entitled to, and did receive 396,732 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(10) George S. Hamilton, the owner of 6,189 shares of common stock, was entitled to, and did receive 866.46 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(11) Edward P. Hamilton, the owner of 1,619.25 shares of
17 common stock, was entitled to, and did receive 226.695 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(12) Throughout the year 1929, the officers of the company were as follows: George S. Hamilton, President; H. C. Gowran, Vice-president; Thomas W. Suddard, Secretary; and Edward J. Hamilton, Treasurer; and these four individuals, together with J. E. Hamilton, constituted the Board of Directors of the company.

A. L. NASH,
Counsel for Petitioner.
C. M. CHAREST,
J. E. M.
Counsel for Respondent.

18 Before United States Board of Tax Appeals

Docket No. 60890
Docket No. 60891
Docket No. 60892
Docket No. 60893

[Title omitted]

Memorandum opinion

Received June 29, 1933. Report and Determination of Division 16

Filed June 29, 1933

McMahon: These proceedings, consolidated for hearing and decision, are for the redetermination of deficiencies in income tax for the year 1929 asserted by the respondent as follows:

Docket No. 60890	$5,831.67
Docket No. 60891	3,570.84
Docket No. 60892	3,771.04
Docket No. 60893	1,158.44

19 It is alleged that the respondent erred in finding that the preferred stock dividend, which the Hamilton Manufacturing Company distributed to petitioners on July 1, 1929, was redeemed by such corporation in such a manner as to make the transaction equivalent to the distribution of a taxable dividend.

Our findings of fact are based upon the pleadings, stipulation entered into between the parties and the testimony of witnesses who testified at the hearing.

The petitioners, H. C. Gowran, George S. Hamilton, and Edward P. Hamilton, are individuals residing at Two Rivers, Wisconsin. The petitioner, Edith Rose Suddard is the duly appointed and qualified executrix of the estate of Thomas W. Suddard, deceased, who died September 11, 1931, having been nominated as such executrix in the will of the decedent. She also resides at Two Rivers, Wisconsin.

The parties entered into the following stipulation:

"(1) Hamilton Manufacturing Company (hereinafter referred to as the company) is a corporation organized under the laws of Wisconsin on February 23, 1926, having its principal office and place of business at the City of Two Rivers, Wisconsin. Article III of its 'Articles of Organization' is as follows:

"'The capital stock of said corporation shall be divided into shares, and shall consist of preferred stock with par value and of common stock without par value, as follows:

"'Ten thousand (10,000) shares of said stock, with a par value of One Hundred Dollars ($100) per share, aggregating One Million

Dollars ($1,000,000.00), shall be preferred stock and bear a preferential cumulative dividend payable out of the net profits of the corporation at the rate of seven per cent. (7%) per annum before any dividends shall be paid upon the common stock; and fifteen thousand (15,000) shares of said stock shall be common stock without any nominal or par value, and every share of such common stock without nominal or par value shall be equal to every other share of such common stock.

"'The holders of shares of said common stock without nominal or par value shall be entitled to all the rights and powers with relation to said stock; and with relation to their right to vote in stockholders' meetings and with relation to choosing directors, which are conferred on stockholders by law and by these Articles of Organization and by the By-Laws of the corporation; and wherever by these Articles of Organization rights and privileges are granted to stockholders or restrictions or limitations are placed upon stockholders, it is hereby declared that only the holders of the common stock are mena unless specifically designated otherwise.

"'The common stock without nominal or par value may be issued by the corporation from time to time, for such consideration as may be fixed from time to time by the Board of Directors thereof.

"'Dividends at the rate of seven per cent. (7%) per annum may be paid by the corporation on its outstanding preferred stock, if the net profits of the corporation shall be sufficient therefor, and may be paid, at the option of the directors, semi-annually or quarterly. The common stock shall not receive dividends for any year unless seven per cent. (7%) shall first be paid for that year on the par value of all the preferred stock then outstanding together with all arrears of dividends on preferred stock at the like rate for previous years; but when seven per cent. (7%) shall have been paid for any year upon the par value of such preferred stock, together with all arrears of dividends at the like rate for previous years, the residue of the net profits of the corporation may then be distributed as dividends ratably to the holders of the common stock. Dividends on either preferred or common stock shall in no case be paid out of corporate assets not accruing from profits.

"'Upon the liquidation or dissolution or winding up of said corporation (whether voluntary or involuntary) the preferred stock shall be entitled to receive out of the assets of the corporation in money or in money's worth the face or par value of the preferred stock then issued and outstanding, and no more; but if upon such liquidation, dissolution or winding up, the corporation shall have, after payment of all its debts and obligations, assets which have accrued from profits the preferred stock shall be entitled to receive out of assets which have accrued from profits (but not out of other assets) payment of all of the seven per cent. (7%) annual dividends which may then be in arrears, but no more. Thereafter the residue of the funds and assets of the corporation

shall be divided equally among the shares of common stock then issued and outstanding.

"'The corporation shall have the right to purchase and redeem any part or all of said preferred stock on January first or July first in any year, by paying for each share of such preferred stock the sum of One Hundred Two and 50/100 Dollars ($102.50) together with all accrued or accruing dividends thereon computed to the date of such redemption; but as a condition of the corporation's right to redeem, it shall give written notice of its intention to so redeem to the holder or holders of such stock, at least thirty (30) days prior to the date fixed by the corporation for such redemption. Said preferred stock, when so redeemed by the corporation, shall be cancelled, but may be again sold and new certificates therefor issued.

"'The holders of preferred stock in said corporation shall have no vote in the meetings of its stockholders nor in choosing directors nor otherwise in the management of the corporation.

"'All certificates evidencing issues of either preferred stock or common stock of the corporation shall bear on the face thereof statement of all privileges accorded to an all restrictions imposed on the preferred stock of the corporation.

"'The corporation may fix a fiscal year by By-Law, which may or may not be identical with the calendar year; and all computations of profits for the purpose of determining whether or not dividends are payable, and to what amount, shall be made upon the profits of each recurring fiscal year if a fiscal year shall be fixed as herein provided, otherwise upon profits of each recurring calendar year.'"

On April 5, 1926, the seventh paragraph of Article III of the "Articles of Organization" was amended to read as follows:

"The corporation shall have the right to purchase and redeem any part or all of said preferred stock on January first or
22 July first in any year, by paying for each share of such preferred stock the sum of One Hundred Five Dollars ($105.00), together with all accrued or accruing dividends thereon computed to the date of such redemption; but as a condition of the corporation's right to redeem, it shall give written notice of its intention to so redeem to the holder or holders of such stock, at least thirty (30) days prior to the date fixed by the corporation for such redemption. Said preferred stock when so redeemed by the corporation shall be canceled, but may be again sold and new certificates therefor issued."

On December 27, 1928, Article III of the "Articles of Organization" was further amended by striking out the first two paragraphs thereof and inserting in their stead the following two paragraphs:

"The capital stock of said corporation shall be divided into shares, and shall consist of preferred stock with par value and of common stock without par value, as follows:

"'Ten thousand (10,000) shares of said stock, with a par value of One Hundred Dollars ($100) per share, aggregating One Million Dollars ($1,000,000.00), shall be preferred stock and bear a prefer-

ential cumulative dividend payable out of the net profits of the corporation at the rate of seven per cent. (7%) per annum before any dividends shall be paid upon the common stock; and thirty thousand (30,000) shares of said stock shall be common stock without any nominal or par value, and every share of such common stock without nominal or par value shall be equal to every other share of such common stock.'"

(2) On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by thirty individuals in amounts ranging from 1 share to 6,189 shares, the petitioners' holdings thereof being as follows:

H. C. Gowran	3,812.25 shares.
Thomas W. Suddard	2,833.8 shares.
George S. Hamilton	6,189 shares.
Edward P. Hamilton	1,619.25 shares.

The four petitioners were holders of common stock of the company throughout the year 1929.

23 (3) On and up to July 1, 1929, the company's preferred stock, issued and outstanding, amounted to 7155 shares, held by approximately 300 individual stockholders, the petitioners holding no shares of preferred capital stock prior to July 1, 1929.

(4) On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05.

(5) At a special meeting of the Board of Directors of the Company held on June 29, 1929, the following transpired:

"On this date at eleven o'clock A. M. the Board of Directors of Hamilton Manufacturing Company, convened pursuant to consent of all directors.

"Director E. P. Hamilton duly offered the following resolution and upon motion made and seconded, it was unanimously adopted by the Board:

"Whereas, on the date of this special meeting of the Board of Directors of Hamilton Manufacturing Company, to-wit: June 29, 1929, the surplus of the company is in excess of $261,531.20; and

"Whereas, the company can at the present time lawfully declare and distribute a dividend to the holders of its common capital stock, in the sum of $261,531.20; and

"Whereas, the outstanding common capital stock of the company on this date is 18,680.8 shares, and a dividend of $14.00 per share on all of said common capital stock would amount in all to $261,531.20; and

"Whereas, of the authorized preferred stock of the company, amounting to 10,000 shares at $100.00 per share, or $1,000,000.00 in all, there remain unissued 2,616 shares or more, having a par value of $261,600.00, which unissued shares of preferred stock are available for issue by way of a stock dividend; and

"Whereas, it is for the best interests of the company and its stockholders that a dividend of $14.00 per share be declared and paid at this time on all of the issued and outstanding common

capital stock of the company, the same to be paid, however, in the preferred stock of the company, computed at the par value thereof, viz.: $100.00 per share; now therefore

"Resolved, by the Board of Directors of Hamilton Manufacturing Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz.: $100.00.

"Resolved Further, that in distributing the stock dividend hereby declared, no fractional shares of preferred stock be made use of, and that the treasurer of the company be and he hereby is directed to adjust with each stockholder, by cash payments (from the stockholder to the company, or from the company to the stockholder, as the case may be), any fractional share by which the company has overpaid or underpaid such stockholder."

* * * * * * *

(6) Pursuant to the foregoing resolution, a stock dividend was paid in shares of the company's preferred stock of the par value of $100.00 per share.

(7) Said stock dividend amounted to $14.00 on every share of common stock then outstanding, or $261,531.20 in all (18680.8 x $14.00); and the same was paid to common stockholders by the distribution to them on July 1, 1929 of 2615.312 shares of the company's preferred stock.

(8) H. C. Gowran, the owner of 3812.25 shares of common stock, was entitled to, and did receive 533.715 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(9) Thomas W. Suddard (now represented by Edith Rose Suddard, Executrix), the owner of 2833.8 shares of common stock, was entitled to, and did receive 396.732 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(10) George S. Hamilton, the owner of 6189 shares of common stock, was enttiled to, and did receive 866.46 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(11) Edward P. Hamilton, the owner of 1,619.25 shares of common stock, was entitled to, and did receive 226.695 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

(12) Throughout the year 1929, the officers of the company were as follows: George S. Hamilton, President; H. C. Gowran, Vice-president; Thomas W. Suddard, Secretary; and Edward P. Ham-

ilton, Treasurer; and these four individuals, together with J. E. Hamilton, constituted the Board of Directors of the Company.

* * * * * * * *

The Hamilton Manufacturing Company had a policy, since its organization, of selling its preferred stock to its employes. Although it had no policy or agreement with its employes to take back any of such stock the Company from time to time repurchased some of the preferred stock from its employes. As the demand for such preferred stock had amounted to only about two or three hundred shares more than had been returned during the fiscal year ended June 30, 1929, the directors of the Company at the time the preferred stock dividend was determined upon were of the opinion that the unissued preferred stock consisting of 229 shares would be sufficient to supply the employes' demand therefor. In September, 1929, it appeared that there was a demand by employes, their near relatives, and stockholders for a total of some 1,800 shares of preferred stock, which demand would have to be met October 1, 1929. The Company issued its stock quarterly on dividend paying dates.

The manner and method of meeting this demand for preferred stock was discussed informally by the four petitioners and one of them suggested that they sell to the Company the preferred stock which they had received as dividends. Two of the petitioners objected because they did not wish to dispose of their preferred stock holdings but after considerable informal discussion it was finally agreed that the four petitioners, together with another stockholder who owned 28 shares, would sell to the Company at par all the preferred stock received by them as dividends on July 1, 1929. It was considered that the previous small demand for the preferred stock did not justify increasing the authorized capital stock of the Company. By the end of the year 1929 a net amount of 475 shares of preferred stock had been disposed of by the Company. A
26 greater number had been actually sold but shares were returned by employes in various amounts, for example, 56 shares were returned in November 1929, and 5 shares in December 1929. However, the supply of preferred stock was exhausted during the fiscal year ended June 30, 1930. On December 31, 1930, the Company had issued 10,526 shares of preferred stock of the par value of $1,052,600, the Company having in the meantime increased its authorized capital of preferred stock to 20,000 shares.

On June 30, 1929, the Company had cash in banks and on hand in the amount of $177,052. On July 1, 1929, the Company was required to pay a cash dividend of $1.75 per share on its outstanding preferred stock of 7,155 shares and $2.50 per share on its outstanding common stock of 18,680 shares, which amounted to a total of $59,221.25.

No proceedings were taken at any time by the Company under its articles of incorporation for the redemption of its preferred stock. No notice required under the provisions of its articles of incorpora-

tion for the redemption of preferred stock was ever issued by the Company. No redemption premium on preferred stock was ever paid by the Company. The Company at no time, either expressly or impliedly, promised to "do anything other than issue this (preferred stock dividend declared June 29, 1929) as a preferred stock dividend" nor did it promise to convert at any time at the option of any stockholder such stock dividend into cash, nor did it grant to any of its stockholders an election or option to take either stock or cash in payment of such dividend.

It is the position of the respondent that in this proceeding there was a distribution and cancellation or redemption made at such time and in such manner as to make it equivalent to the distribution of a taxable dividend under section 115 (g) of the Revenue Act of 1928.[1]

It is contended by the petitioners that the transaction involved herein was a sale by the petitioners on October 1, 1929, to the Hamilton Manufacturing Company of its preferred stock issued to the petitioners on July 1, 1929, as a stock dividend, to supply the
27 Company with sufficient stock to meet demands made therefor by its employes, their near relatives, and stockholders.

In our opinion, this proceeding is governed by Alfred A. Laun, 26 B. T. A. 764, cited and relied on by petitioners; and upon the authority of our decision in that proceeding we hold in favor of the petitioners. See that case for authorities cited therein and discussion.

In Henry B. Babson, 27 B. T. A.—No. 55, the Board in its opinion states as follows:

"These cases (Alfred A. Laun, supra, Pearl B. Brown, Executrix, 26 B. T. A. 901; Harry A. Koch, 26 B. T. A. 1025; Robert R. Meyer, 27 B. T. A. 44; Annie Watts Hill, 27 B. T. A. 73) lay as one test for determining whether a distribution in cancellation or redemption of stock falls within the provisions of the statute, the existence of a relation between the issuance and redemption of the stock which evidences a continuing plan to effect by this means a distribution of corporate earnings, freed from the usual incident of tax upon ordinary dividend distribution. * * *

"But, as another test of the applicability of the statute to transactions such as these before us, we must scrutinize the redemption and distribution with respect to the time and manner when they occur, and the circumstances surrounding them at that time." Annie Watts Hill, supra.

In the instant proceeding the Company by resolution declared a preferred stock dividend, which was issued July 1, 1929. Redemption of the outstanding preferred stock, or any of it, was not

[1] Sec. 115. (g) *Redemption of stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. * * *

authorized by the Company at that time, and the preferred stock issued to the petitioners July 1, 1929, as a stock dividend, was not redeemed by the Company as provided in its articles of incorporation. However, it appears that the petitioners, at some time subsequent to September 1929, agreed to sell at par to the Company all of the preferred stock issued to them as dividend on July 1. The Company purchased such preferred stock from the petitioners at par on or about October 1, 1929, and sold all of it, together with its unissued preferred stock, to others before June 30, 1930. Thereafter, because of the continued demand for its preferred stock, the Company increased its authorized capital preferred stock so as to supply the demand. The petitioner, H. C. Gowran, vice-president and director of the Company, testified that before deciding to turn in the stock to the Company the petitioners considered the questions

28 (1) whether to close the issuance of any more preferred stock, (2) whether to increase the authorized preferred stock or (3) whether to redeem the preferred stock or some of it at the call price of $105; but that the petitioners finally determined to sell the stock to the Company, and he stated that—

"There was no reason for us selling it back to the company absolutely. We could have sold it to the individuals personally, and there never would have been a question raised. * * * It was put back in the Company for the convenience of the employes."

Furthermore, there was no cancellation of the preferred stock within the meaning of section 115 (g). It is true that the certificates representing the preferred stock issued to the petitioners on July 1 were returned to the Company and cancelled, but other certificates were issued in their stead to those having made demand for the Company's preferred stock prior to October 1, or to those who thereafter purchased preferred stock of the Company. The Company's stock liability remained approximately the same except during the short interim between the purchase of the preferred stock from the petitioners and the sale of the same to others as heretofore pointed out. In fact the stock liability of the Company subsequently increased as its total authorized preferred stock was issued and outstanding June 30, 1930.

The Company was in a position to pay petitioners for their preferred stock sold to it out of funds received from the later sales of the same stock and it was not necessary for the Company to distribute profits to acquire the same.

In our opinion, the Company did not cancel or redeem in the year 1929 preferred stock issued by it as a stock dividend to the petitioners at such time and in such manner as to make the distribution and cancellation in whole or in part essentially equivalent to the distribution of a taxable meaning of section 115 (g). See T. Pierre Champion, 27 B. T. A.—No. 139 and Louis Rorimer, 27 B. T. A.—No. 56.

Decision will be entered under Rule 50.

Enter June 29, 1933.

29 Before United States Board of Tax Appeals

(Caption—60890–3)

Motion for reconsideration, etc.

Filed July 16, 1933

The respondent by his attorney, E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, moves (1) for reconsideration of the "Memorandum Opinion" entered June 29, 1933, in the above-styled proceedings, (2) for review by the Board as provided by Section 906 (d) of the Revenue Act of 1924, as amended by Section 1000 of the Revenue Act of 1926, and (3) for judgment for the respondent.

GROUNDS OF MOTION

The "Memorandum Opinion" is in conflict with the case of Tillotson Manufacturing Company v. Commissioner, decided by the Board on March 11, 1933 (27 B. T. A.———).

ARGUMENT IN SUPPORT OF MOTION

In deciding the Tillotson Manufacturing Company case, the Board laid down the principles that not every dividend in stock is a stock dividend, and that only those which place the shareholders in no essentially different position are exempt. The Board there held that the dividend on preferred stock of Willys-Overland Company paid in its own common stock to Tillotson Manufacturing Company was not a stock dividend.

The facts briefly are as follows:

Article III of the "Articles of Organization" of Hamilton Manufacturing Company, a Wisconsin corporation organized February 23, 1926, as amended on April 5, 1926, and again on December 26, 1928, discloses that the company had a capital structure of 10,000 shares of preferred stock of the par value of $100.00 each and 30,000 shares of common stock without nominal or par value; that the holders of the common stock are entitled to all the rights and powers with relation to said stock and with relation to their right to vote in stockholders' meetings and to choose directors; that the holders of the preferred stock are entitled to cumulative dividends of 7% and to receive, upon liquidation or dissolution or winding up of the
30 company, the face or par value of the preferred stock then issued and outstanding, but the holders of the preferred stock have no vote in the meetings of the stockholders nor in choosing directors nor otherwise in the management of the company.

On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by thirty individuals

in amounts ranging from 1 share to 6189 shares, the petitioners' holding thereof being as follows:

H. C. Gowran	3,812.25 shares.
Thomas W. Suddard	2,833.8 shares.
George S. Hamilton	6,189 shares.
Edward P. Hamilton	1,619.25 shares.

The four petitioners were holders of common stock of the company throughout the year 1929.

On and up to July 1, 1929, the company's preferred stock, issued and outstanding, amounted to 7,155 shares, held by approximately 300 individual stockholders, the petitioners holding no shares of preferred capital stock prior to July 1, 1929.

On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05.

At a special meeting of the Board of Directors of the company held on June 29, 1929, the following resolution was passed:

"Resolved, by the Board of Directors of Hamilton Manufacturing Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz: $100.00."

H. C. Gowran, the owner of 3812.25 shares of common stock, was entitled to, and did receive 533.715 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

Thomas W. Suddard (now represented by Edith Rose Suddard, Executrix), the owner of 2833.8 shares of common stock, was
31 entitled to, and did receive 396.732 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

George S. Hamilton, the owner of 6189 shares of common stock, was entitled to, and did receive 866.46 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

Edward P. Hamilton, the owner of 1619.25 shares of common stock, was entitled to, and did receive 226.695 shares of the company's preferred stock pursuant to the resolution passed at the special meeting of the Board of Directors on June 29, 1929.

Throughout the year 1929, the officers of the company were as follows: George S. Hamilton, President; H. C. Gowran, Vice President; Thomas W. Suddard, Secretary; and Edward P. Hamilton, Treasurer; and these four individuals, together with J. E. Hamilton, constituted the Board of Directors of the company.

In the Tillotson Manufacturing Company case, the Board says:

"Analyzing the facts in this proceeding in the manner prescribed in Eisner v. Macomber, supra, the want of essential similarity is immediately apparent. This was not a proportional redistribution of existing or inchoate rights. There was a substantial change in the shareholder interests not only of this petitioner but of all other shareholders as well. Whether the adventitious effect of this at any given time to any one shareholder be for better or worse may serve to measure the gain or loss, but it leaves the change no less substantial. This petitioner as a preferred shareholder not only enjoyed the benefits of its preference and the assurance which the provision for cumulative dividends might give, but it also was subject to the limitations of a fixed dividend and a contingent right to vote. By this dividend, it acquired new and separate rights of a common shareholder to participate in unlimited dividends and liquidations and unqualifiedly in the shareholders' meetings."

The only essential difference between the two cases is that Tillotson Manufacturing Company received common stock as a dividend on preferred stock, while the petitioners here received preferred stock as a dividend on common stock. This difference is of no consequence. The same principle applies. The privileges enjoyed by petitioners as common stockholders were different from their privileges as preferred stockholders in the same respects as set forth in the Tillotson Manufacturing Company case; and further, only as common stockholders did petitioners have the right to vote in the meetings of stockholders, to choose directors and to have a voice in the management of the company.

32

A stipulation filed with the Board refers to the dividend as a "stock dividend", and it was on this theory that the deficiencies were determined and the cases presented to the Board. However, the Board is not bound by a conclusion of law. (John A. Nelson Co. v. Commissioner, decided by the Board on June 23, 1933.) A resolution dealing with the dividend is a part of the stipulation.

"Whether there has been a tax-free stock dividend is to be determined not by the terms used but by an analysis of the legal effect of what was done in the name of a stock dividend." Tillotson Manufacturing Co. v. Commissioner, supra.)

But one more point remains—the fair market value of the preferred stock on July 1, 1929, the date of distribution. The deficiency notice treats this stock as taxable at $100.00 per share. Consequently, if the stock had a fair market value of $100.00 per share, the deficiency determined by the Commissioner is correct and should be sustained.

With respect to this latter point, Article III of the "Articles of Organization", as amended, provides for redemption of the preferred stock at $105.00 per share on January 1 or July 1 in any year. On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05. The company had a policy of selling preferred stock to its employees. In the year prior to July

1, 1929, some two or three hundred shares were purchased by the employees. A demand for the stock arose immediately after July 1, 1929. It sold for $100.00 per share without solicitation. Everybody had money, and most of the employees paid all cash for preferred stock. By the end of September 1929, the demand for this stock had risen to about 1800 shares. The founder of the company and chairman of the Board of Directors, J. E. Hamilton, purchased
1500 shares at $100.00 per share, paying all cash. It is sub-
33 mitted that the facts amply support a finding that the preferred stock on July 1, 1929 had a fair market value of $100.00 per share.

Wherefore, it is prayed that this motion be granted.

E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
J. E. MARSHALL,
Special Attorney, Bureau of Internal Revenue.

Before United States Board of Tax Appeals

(Caption—60890-3)

Order denying motion for review

Entered July 24, 1933

The Board having entered its memorandum opinion in the above-entitled proceedings on June 29, 1933, the respondent filed a motion on July 18, 1933, requesting review by the Board of the said memorandum opinion, and upon consideration of said motion and the grounds set forth in support thereof, it is

Ordered, That the said motion be and the same is hereby denied.

(Signed) LOGAN MORRIS, *Chairman.*

Dated, Washington, D. C., July 24, 1933.

Before United States Board of Tax Appeals

(Caption—60890-3)

Order denying motion for reconsideration, etc.

Entered Jan. 15, 1934

Counsel for the respondent having on July 18, 1933, filed a motion (1) for reconsideration of the "Memorandum Opinion" entered June 29, 1933, in the above-entitled proceedings, (2) for review by the Board as provided by Section 906 (d) of the Revenue Act of 1924, as amended by Section 1009 of the Revenue Act of 1926, and (3) for

judgment for the respondent; on the ground that such "Memorandum
Opinion" is in conflict with the case of Tillotson Manufactur-
34 ing Co., 27 B. T. A. 913, and the motion (2) for review by the
Board having been denied by order dated July 24, 1933; and a hearing on the motions (1) for reconsideration and (3) for judgment for the respondent having been had on August 28, 1933; and the motions and reasons therefor submitted by respondent with his said motions and argument of counsel at the hearing and on briefs having been duly considered, now, therefore, it is

Ordered that the motions of respondent for reconsideration of the "Memorandum Opinion" entered June 29, 1933, in the above-entitled proceedings and for judgment for the respondent be and the same hereby are denied. (See Memorandum attached.)

(Signed) STEPHEN J. MCMAHON, *Member.*

Dated: Washington, D. C., January 15, 1934.

Before United States Board of Tax Appeals

(Caption—60890-3)

Memorandum on motion for review, etc.

In his motion filed July 18, 1933, the respondent moved, among other things, for reconsideration of the "Memorandum Opinion" entered June 29, 1933, in the above-entitled proceedings for judgment for the respondent on the ground that the "Memorandum Opinion" entered in these proceedings is in conflict with the case of Tillotson Manufacturing Co., 27 B. T. A. 913, which held that a dividend declared upon cumulative nonvoting preferred shares payable in common voting shares is, as to the preferred shareholder, not a tax-free stock dividend, for the reason that there "was not a proportional redistribution of existing or inchoate rights. There was a substantial change in the shareholder interests not only of this petitioner but of all other shareholders as well."

In the instant proceedings a dividend was declared upon common stock payable in preferred stock. At the time of the declaration of the dividend payable in preferred stock, the interest of the common stockholders in the corporation was represented by the amount of the capital stock outstanding plus the amount of the surplus. Part of this surplus was set aside as dividends payable in preferred stock. Thus, as stated in Eisner v. Macomber, 253 U. S. 189,

This, however, is no more than a book adjustment, in essence
35 not a dividend but rather the opposite; no part of the assets of the company is separated from the common fund, nothing distributed except paper certificates that evidence an antecedent increase in the value of the stockholder's capital interest resulting from an accumulation of profits by the company, but profits so far absorbed in the business as to render it impracticable to separate them for with-

drawal and distribution. In order to make the adjustment, a charge is made against surplus account with corresponding credit to capital stock account, equal to the proposed "dividend"; the new stock is issued against this and the certificates delivered to the existing stockholders in proportion to their previous holdings. This, however, is merely bookkeeping that does not affect the aggregate assets of the corporation or its outstanding liabilities; it affects only the form, not the essence, of the "liability" acknowledged by the corporation to its own shareholders, and this through a readjustment of accounts on one side of the balance sheet only, increasing "capital stock" at the expense of "surplus"; it does not alter the pre-existing proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. * * *

* * * * * * *

We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital, at the same time shows he has not realized or received any income in the transaction.

To similar effect is Frances Elliot Clark, 28 B. T. A. 1227.

Furthermore, in Tillotson Manufacturing Co., supra, the Board held that the petitioner in that case as a preferred stockholder

"not only enjoyed the benefits of its preference and the assurance which the provision for cumulative dividends might give, but it also was subject to the limitations of a fixed dividend and a contingent right to vote. By this dividend, [common stock to preferred stockholders] it acquired new and separate rights of a common shareholder to participate in unlimited dividends and liquidations and unqualifiedly in the shareholders' meetings."

Such is not the case in these proceedings. As common
36 stockholders the petitioners in these proceedings had and enjoyed all the rights, prior to the issuance of the stock dividend, which the petitioner in Tillotson Manufacturing Co., supra, as a preferred stockholder did not have, but which it acquired with the receipt of the common stock as a dividend. The petitioner in these proceedings, as common stockholders, prior to the issuance of the preferred stock dividend, had and enjoyed the "separate rights of a common shareholder to participate in unlimited dividends and liquidations and unqualifiedly in the shareholders' meeting." On the other hand, as stated before, a portion of that which represented the book value of the common stock held by the petitioners in these proceedings, or a portion of their interest in the corporation, was set aside from surplus to capital. In other words, they received in preferred stock a portion of their then interest in the corporation.

The motion of the respondent should therefore be denied.

STEPHEN J. MCMAHON, *Member.*

Before United States Board of Tax Appeals

(Caption—60890–3)

Order vacating order of Jan. 15, 1934, etc.

Nov. 20, 1934

In these proceedings a Division of the Board entered its Memorandum Opinion on June 29, 1933, and on July 18, 1933, the respondent filed a motion for (1) Board review of the Opinion, (2) reconsideration and (3) judgment for the respondent. The motion states that the opinion is in conflict with Tillotson Manufacturing Co., 27 B. T. A. 913. The motion was denied as to its request for Board review and set for hearing as to its two other requests. Subsequent to the hearing, Division No. 16 of the Board entered an order, dated January 15, 1934, denying the motion for reconsideration and judgment. On January 26, 1934, respondent moved for Board review of such order. On January 31, 1934, the Board reviewed that order and accompanying memorandum of Division No. 16, dated January 15, 1934. Upon that review, and the record as then constituted, such order was disapproved by the Board and accordingly, by direction of the Board, it is

37 Ordered, that the aforementioned order dated January 15, 1934, be and the same is hereby vacated, and it is

Further Ordered that respondent's motion for reconsideration of the Memorandum Opinion entered June 29, 1933, be and the same is hereby granted.

[SEAL] (Signed) J. RUSSELL LEECH, *Member.*

Dated: Washington, D. C. November 20, 1934.

McMahon dissents upon the record, disclosing, among other things, a tax free stock dividend the value of which is immaterial here.

Before United States Board of Tax Appeals

(Caption—60890–3)

Motion to vacate order of Nov. 20, 1934, etc.

Filed at Hearing Feb. 13, 1935

The petitioners above named, by their attorney, A. L. Nash, move (1) that the order made in these proceedings by J. Russell Leech, Member of the Board, under date of November 20, 1934, whereby respondent's motion for reconsideration of the memorandum opinion entered June 29, 1933, was granted, be vacated and set aside; (2) that respondent's said motion for reconsideration of the memorandum opinion be denied; and (3) that judgment be ordered for the petitioners in accordance with the prayer of their petitions.

GROUNDS OF MOTIONS

I

1. On June 29, 1933, Division 16 of the Board made a memorandum decision, finding in favor of petitioners on the issue raised by the petitions and the answers of the respondent.

2. On July 24, 1933, review of the decision of Division 16 was denied by the Board.

3. No review of the decision of Division 16 of the Board was ordered by the Chairman of the Board, or otherwise, within thirty days after the date of said memorandum decision.

4. The memorandum decision became the decision of the Board thirty days after June 29, 1933, or on July 29, 1933.

38 5. No petition for review by the United States Circuit Court of Appeals was filed within three months after the memorandum decision above mentioned became the decision of the Board.

6. The respondent's motion for reconsideration of the memorandum decision of Division 16 of the Board was argued in Chicago on August 28, 1933, and was denied by an order of Division 16 dated January 15, 1934; and if it should be the law that this pending motion for reconsideration stopped the running of the time for the filing of a petition for review, then it appears that the time for filing a petition for review began to run on January 15, 1934, and expired on April 15, 1934.

7. Respondent's motion, made January 26, 1934, was merely for review by the Board of the order denying reconsideration made on January 15, 1934, and said last mentioned motion did not stop the running of the statutory time limit, so that the decision of the Board, dating from July 29, 1933, became final in any event on April 15, 1934.

For these reasons the first motion set forth above should be granted, viz.: that the order signed by J. Russell Leech, Member of the Board, dated November 20, 1934, granting respondent's motion for reconsideration, should be vacated because made and entered long after the Board's decision in the proceedings had become final.

II

1. For the same reasons set forth above, it is urged that respondent's motion for reconsideration of said memorandum opinion should be denied by an order at this time.

III

1. For the same reasons set forth above, and because the decision of the Board, of date July 29, 1933, became final not later than April

15, 1934, petitioners' motion for judgment in their favor should be granted.

Dated February 13, 1935.

A. L. Nash,
A. L. Nash,
Attorney for Petitioners,
Manitowoc Savings Bank Bldg., Manitowoc, Wisconsin.

Denied June 27, 1935. (s) J. Russell Leech, Member U. S. Board of Tax Appeals.

39 Before United States Board of Tax Appeals

(Caption—60890–3)

Stipulation re certain fact

Filed Feb. 13, 1935

(Read into the Record February 13, 1935)

Mr. Nash: * * * Now, counsel may dictate the stipulation. and then I will dictate my condition.

Mr. Thomas: It is hereby stipulated and agreed, by and between the parties hereto, by their respective counsel, that for the purpose of these proceedings the following fact may be taken as true;

That the fair market value of the preferred stock of the Hamilton Manufacturing Company as of July 1, 1929, was $100 per share.

Mr. Nash: Now for the petitioners, your Honor, the stipulation just dictated into the record by counsel for respondent is admitted as true, with this reservation, that the fact stipulated is immaterial and irrelevant, for the reason that the dividend disclosed by the record was a tax-free stock dividend, so that the value of the shares of preferred stock distributed in such stock dividend has no bearing on the case; and the admission of petitioners of the stipulated facts, is made without prejudice to their rights to maintain, in argument or otherwise, their claim that such stock dividend was tax-free.

Before United States Board of Tax Appeals

(Caption—60890–3)

Promulgated June 27, 1935

Dividends.—Where both common and preferred shares are outstanding when a dividend is declared upon voting common stock and paid in nonvoting cumulative preferred shares at par value, such dividend is not a tax-free stock dividend. Tillotson Manufacturing Co. v. Commissioner, 76 Fed. (2d) 189, affirming 27 B. T. A. 913; James H. Torrens, 31 B. T. A. 787, followed.

A. L. Nash, Esq., for the petitioners.

Isadore Graff, Esq., for the respondent.

Opinion

Filed June 27, 1935

LEECH: These consolidated proceedings are under reconsideration pursuant to the Board's order dated November 20, 1934. By order dated November 24, 1934, the proceedings were set for hearing evidence limited to the fair market value on July 1, 1929, of the Hamiltion Manufacturing Co. preferred stock. At such rehearing on February 13, 1935, petitioners filed a motion that the Board vacate its order directing reconsideration, that the Board deny respondent's motion for reconsideration of the memorandum opinion heretofore entered, and that the Board enter judgment for petitioners. The principal ground for such motion is that the memorandum opinion had become final and that the Board was without authority, on November 20, 1934, to direct a reconsideration. In these proceedings the Board has never entered its final order, pursuant to section 601 (d) of the Revenue Act of 1928. Thus, the Board, not having entered its decision in these proceedings, has the power to reopen the cases and revise its prior findings of fact and opinion. Washburn Wire Co. v. Commisioner, 67 Fed. (2d) 658. Accordingly, petitioners' motion filed on February 13, 1935, is denied.

The respondent has determined income tax deficiencies for the year 1929 in the following amounts:

Docket No. 60890	$5,831.67
Docket No. 60891	3,570.84
Docket No. 60892	3,771.04
Docket No. 60893	1,158.44

He determined that preferred shares issued as a dividend on the common shares of the Hamilton Manufacturing Co., on July 1, 1929, were redeemed by the company in such a manner as to make the distribution essentially equivalent to the distribution of a taxable dividend under section 115 (g) of the Revenue Act of 1928.

The petitioners assigned error in such determination.

The Board, in its memorandum opinion heretofore entered, considered the proceedings only upon the basis of such assigned error and determined, upon the facts, that the preferred stock was not redeemed in 1929 in such a manner as to make the distribution essentially equivalent to the distribution of a taxable dividend. The parties did not specifically raise, nor did the Board consider, the question of whether the dividend was tax-free or taxable to
41 petitioners when the shares were issued on July 1, 1929. The latter question has now been specifically raised by the granting of the respondent's motion for reconsideration on the ground that the memorandum opinion, heretofore entered, is in conflict with the decision in Tillotson Manufacturing Co. v. Commissioner, 76 Fed. (2d) 189, affirming 27 B. T. A. 913.

In deciding now whether the present dividend was tax-free or taxable, we are not considering a new issue raised for the first time

by respondent's motion. The deficiency in controversy is asserted upon the basis of the respondent's determination that the dividend was taxable. The correctness of that deficiency is the general issue, in the consideration of which the Board is not limited to the theory advocated by either the respondent or the taxpayer. Charles L. Coughlin, 15 B. T. A. 515, 519; James P. Gossett, 22 B. T. A. 1279; affd., 59 Fed. (2d) 365; John I. Chipley, 25 B. T. A. 1103. The question before the Board now, as originally, inherently involves the taxable character of the dividend revealed by the evidence of record. If it be determined that the dividend was not a tax-free stock dividend when made on July 1, 1929, and therefore properly includable in income, that conclusion would be decisive here without passing upon the question of whether there was a redemption within the meaning of section 115 (g) of the 1928 Act.

There follow only those facts necessary to a determination of the one question now under consideration.

The petitioners, H. C. Gowran, George S. Hamilton, and Edward P. Hamilton, are individuals residing at Two Rivers, Wisconsin. The petitioner, Edith Rose Suddard, is the duly qualified executrix of the estate of Thomas W. Suddard, deceased, who died testate September 11, 1931. She also resides at Two Rivers, Wisconsin.

Hamilton Manufacturing Co., hereinafter referred to as the company, was incorporated on February 23, 1926, under the laws of Wisconsin. Article III of its "Articles of Organization" as amended on April 5, 1926, and on December 27, 1928, provides that the company's capital stock shall be divided into 10,000 shares of preferred stock of the par value of $100 each, entitled to a preferential cumulative dividends at the rate of 7 percent per annum, payable out of net profits; and 30,000 shares of common stock without nominal or par value. Article III further provides that the holders of common stock shall have certain rights and powers, including voting rights,

> and, that the company shall have the right to purchase and
> 42 redeem any part or all of the preferred stock on the first of
> January or July in any year, by paying $105 for each share

together with accrued dividends, and that the preferred stock when so redeemed and canceled, may be reissued.

On July 1, 1929, the company's common capital stock, issued and outstanding, amounted to 18,680.8 shares held by 30 individuals in amounts ranging from 1 share to 6,189 shares.

Prior to July 1, 1929, the company's preferred stock, issued and outstanding, amounted to 7,155 shares held by approximately 300 individual stockholders. The petitioners held no shares of the company's preferred capital stock prior to July 1, 1929.

On July 1, 1929, the company's earned surplus available for distribution was not less than $444,147.05.

The company's board of directors, at a special meeting on June 29, 1929, adopted a resolution which, after setting forth that the company's surplus was in excess of $261,531.20, the total of a $14 per

share dividend on 18,680.8 common shares outstanding, and that there remained unissued $261,600 par value preferred stock available for issue by way of stock dividend, provided in part as follows:

"Resolved, by the Board of Directors of Hamilton Mfg. Company, that there be and there hereby is declared a dividend on all of the outstanding common capital stock of the company, to the holders thereof of record on July 1, 1929, amounting to $14.00 per share, and that the officers of the company be and they hereby are directed to pay and distribute said dividend forthwith to said stockholders of record, pro rata to each in proportion to his present holdings of common stock, in the form of certificates of the company's preferred stock, each share of said preferred stock so distributed to be taken at its par value, viz: $100."

The petitioners' holdings of common shares on July 1, 1929, and the number of preferred shares each was entitled to and did receive pursuant to the above mentioned resolution, were as follows:

	Common shares	*Preferred shares*
H. C. Gowran	3,812.25	533.715
Thomas W. Suddard	2,833.80	396.732
George S. Hamilton	6,189.00	866.46
Edward P. Hamilton	1,619.25	226.695

43 The preferred stock so received by petitioners on July 1, 1929, had a fair market value of $100 per share on that date. Subsequent to September 1929 petitioners agreed to sell to the company at par, all the preferred stock issued to them as a dividend, and on or about October 1, 1929, the company purchased at par all such preferred stock, for resale to its employees.

Petitioners argue that the present dividend on common stock declared and paid in preferred stock of the declarant company, is a stock dividend within the meaning of section 115 (f) of the Revenue Act of 1928,[1] and is, therefore, not taxable.

The authorities upon which they rely are: Alfred A. Laun, 26 B. T. A. 764; Pearl B. Brown, Executrix, 26 B. T. A. 901; affd., 69 Fed. (2d) 602; certiorari denied, 293 U. S. 570; and Frances Elliott Clark, 28 B. T. A. 1225; affd., — Fed. (2d) — (C. C. A., 3d Cir., March 26, 1935).

In all those cases, no preferred stock was outstanding when the preferred in question was distributed as a dividend on or in partial exchange for common stock. Thus, since (1) there was no severance of assets from the declarant corporations, and (2) there was no alteration of the preexisting proportionate interest of the stockholders, but "only a proliferation of preexisting interests" (Pearl B. Brown, Executrix, supra) the disputed dividend was held non-taxable. (Tillotson Manufacturing Co. v. Commissioner, supra.)

In that case, which petitioners attempt to distinguish from the pending situation, there was a substantial amount of common stock outstanding when the dividend on the preferred stock, payable in

[1] Sec. 115 (f). Stock dividends.—A stock dividend shall not be subject to tax.

common, was declared and paid. That fact sustains the Board's conclusion that the second prerequisite above, to the exemption of that dividend from tax, was not there established. The position of the stockholder in receiving such common stock in that distribution was materially changed. He acquired substantially different and, as the court there held, "additional property rights which might well afford him a different and greater market with an increased money return."

So, here as in the Tillotson case, though the first of the two recognized tests (supra) for distinguishing a taxable from a non-taxable dividend, may have been met, the second has not. The pre-
44 existing proportionate interest of the stockholders was substantially changed. It is true that the present record discloses the converse situation as to the class of stock in which the dividend was declared and paid, but in the recent case of James H. Torrens, 31 B. T. A. 787, in applying the rule announced in the Tillotson case to similar facts, this Board said:

"If there be any difference in the degree of change effected in the stockholders' existing rights by the converse factual situation here, we do not think it sufficient to except this case from the application of that rule."

Our immediately pertinent inquiry is the taxable status of this new preferred stock, not from the standpoint of the corporation, but from that of the common stockholders. What did the petitioners, as common stockholders, receive? Here, not only was there a substantial amount of preferred stock of the declarant company outstanding when the present dividend on common was declared and paid in preferred stock, but none of that preferred was then owned by petitioners. The rights and attributes of these preferred and common stocks were materially different. Despite the mechanics of the corporate bookkeeping, which certainly do not control the taxable character of the disputed dividend in the hands of the petitioners (Doyle v. Mitchell Bros., 247 U. S. 179), they, as common stockholders, by the receipt of the present preferred stock, as a dividend, received rights in the assets of the corporation, as to future dividends, and upon liquidation, which were, before receipt of that preferred stock, limited to the then outstanding preferred stock. By the distribution of the preferred stock here, the then existing rights of petitioners, common stockholders, were increased, and those of the then preferred stockholders were decreased, to that extent. Nor is the effect of that fact in evaluating the difference between petitioner's rights before and after the receipt of the questioned preferred stock, avoided here by the financial condition of the corporation at the time of that receipt. Petitioner's rights, though constant in extent during each of those respective periods, were subject to fluctuation in value with that financial condition during each of such periods. It is that continuing potentiality of the common stockholders' new and proportionately altered interests, inherent in the preferred stock in dispute, not the mere liquidating value of that

stock at any particular time, which gave petitioners "additional property rights which might well afford them a different and greater market with an increased money return." Tillotson Manufacturing Co. v. Commissioner, supra.

45 The disputed dividend, on common stock, declared and paid in preferred stock of the declarant company, of a fair market value of $100 per share, when issued on July 1, 1929, was not a tax-free stock dividend.

The memorandum opinion heretofore entered in these proceedings is modified accordingly.

Reviewed by the Board.

Decision will be entered pursuant to Rule 50.

BLACK dissents.

Before United States Board of Tax Appeals

Dissenting opinion

MCMAHON, dissenting: The result reached by the majority in these proceedings is contrary to applicable and corresponding provisions of the revenue acts,[2] rulings and regulations of the Secretary of the Treasury promulgated thereunder,[3] rulings of the Bureau of Internal Revenue,[4] provisions of the Federal Constitution,[5] decisions of the courts,[6] and this Board,[7] and long continued, persistent, uniform practice of the officers charged with the administration of such revenue acts, all of which are controlling here.[8]

The conclusion is unavoidable that Congress has clearly expressed its intention to *exempt all stock dividends from income tax.* Beginning with the 1921 Act, Congress, in section 201 (d), provided that a "*stock dividend* shall not be subject to tax." The term "stock dividend" is a broad term. The language used is plain, simple, and direct. It is here used in its ordinary sense and must be so applied. Congress did not limit or restrict it to any particular type of

46 stock or stock of any particular class or to stock where stock of the same class *is not outstanding.* Obviously, if Congress had intended such limitation it would have so provided.

Congress in section 115 (a) of the applicable 1928 Act defined a taxable dividend as "any *distribution* made by a corporation to its

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[2] Sec. 115 (a), (f), (g), 1928 Act; sec. 201 (a), (f), (g), 1926 Act; sec. 201 (a), (f), 1924 Act; and sec. 201 (a), (d), 1921 Act.

[3] Arts. 628 and 600, Regulations 74; arts. 1548 and 1599, Regulations 69; arts. 1548 and 1599, Regulations 65; art. 1548, Regulations 62; T. D. 3052 and T. D. 3059, 3 C. B. 38 (July–Dec. 1920).

[4] I. T. 2538, IX–1 C. B. 144 (1930); G. C. M. 6709, VIII–2 C. B. 132 (1929); and O. D. 801, 4 C. B. 24 (Jan.–June 1921).

[5] The Sixteenth Amendment and Art. I, sec. 2, cl. 3; Art. I, sec. 9, cl. 4.

[6] Eisner v. Macomber, 252 U. S. 189; Gibbons v. Mahon, 136 U. S. 156; Towne v. Eisner, 245 U. S. 418; United States v. Phellis, 257 U. S. 156; and Weiss v. Stearn, 265 U. S. 242.

[7] Alfred A. Laun, 26 B. T. A. 764; Pearl B. Brown, Executrix, 26 B. T. A. 901; affd., Commissioner v. Brown, 69 Fed. (2d) 602; certiorari denied, 293 U. S. 570; Robert R. Meyer, 27 B. T. A. 44; Louis Rorimer, 27 B. T. A. 871; T. Pierre Champion, 27 B. T. A. 1312; Shelby H. Curlee, Trustee, 28 B. T. A. 773; and Frances Elliott Clark, 28 B. T. A. 1225.

[8] For a fuller discussion of the foregoing citations, with the exception of the Phellis and Weiss cases, see the dissenting opinion in James H. Torrens, 31 B. T. A. 787, 803. 32 B. T. A.

shareholders *whether in money or in other property, out of its earnings of profits* accumulated after February 28, 1913." This definition contains two classes of dividends, i. e., (1) dividends "in money" and (2) dividends "in other property", but both must be "*distributions* * * * *out of its earnings or profits* accumulated after February 28, 1913." (Emphasis supplied.) This section does not include any other classification of dividends, as did the 1916 and 1918 Acts,* the latter including a third classification of dividends "in stock of the corporation." The provision taxing dividends "in stock of the corporation" is the one that was declared unconstitutional in Eisner v. Macomber, supra; and it was therefore omitted in the 1921 Act and subsequent corresponding acts.

In section 115 (f) and (g), of the 1928 Act, and corresponding sections of previous acts back as far as the 1921 Act, Congress dealt only with two kinds of stock dividends, i. e., (1) a "true stock dividend made lawfully and in good faith", Eisner v. Macomber, supra, and (2) a stock dividend not made lawfully or in good faith, or one made to circumvent taxation. However, Congress did not even provide that a *stock dividend* not made lawfully and in good faith should be subject to tax. It provided that if after the issuance of a stock dividend the corporation proceeds to cancel or redeem its stock at such time and in such manner as to make the issuance of such stock and the cancellation or redemption thereof essentially equivalent to the payment of a taxable dividend *the amount received in redemption or cancellation of the stock* shall be treated as a taxable dividend to the extent of the earnings or profits accumulated after February 28, 1913. It is the *amount* subsequently paid by the corporation in cancellation or redemption of such stock dividend not made in good faith that is taxable to the stockholder when received. Hence, when Congress provided that a "stock dividend shall not be subject to tax", it meant every stock dividend of whatever type or class.

Since it was held in Eisner v. Macomber, supra, that Con-
47 gress had no power under the Constitution to tax a dividend in common stock issued to holders of common stock, it was not necessary for Congress to legislate to exempt such common stock dividend from tax. Such legislation would have been futile. Congress had a reason for enacting the provision that a "stock dividend shall not be subject to tax." Cf. National Bank of the Republic of Chicago, 31 B. T. A. 680. This provision accomplishes the purpose of removing any question about the taxability of stock dividends other than common stock on common stock. This is not contrary to Eisner v. Macomber, supra. It is in keeping with it.

As disclosed by T. D. 3059, supra, and subsequent regulations, officers charged with the administration of the revenue acts have repeatedly ruled that *a stock dividend "in whole or in part of a character and preference materially different from the stock upon*

* Sec. 2 (a), 1916 Act; sec. 201 (a) (c), 1918 Act. 32 B. T. A.

which the stock dividend is paid" [emphasis supplied] is *not taxable* income to the stockholder receiving the same.

The substantial reenactment in later acts of provisions theretofore construed by administrative officers is persuasive evidence of legislative approval of the administrative interpretation.[10]

If it were the intention of Congress that the provision of the Revenue Act of 1921 and subsequent acts that a "stock dividend shall not be subject to tax" should apply only to stock dividends issued in common shares upon common shares and the meaning of the term "stock dividend" should be so limited, then such provision, viewed from the standpoint of the facts of the instant proceedings, would be unconstitutional because contrary to Article I, section 2, clause 3, and Article I, section 9, clause 4, of the Federal Constitution, requiring that direct taxes shall be apportioned according to population, and also because contrary to the Sixteenth Amendment, since the stock dividend issued in preferred stock to holders of common stock out of surplus, when other preferred stock is outstanding, represents a portion of the *capital* interest of the holders of common stock or a portion of the "enrichment through increase in value of *capital* investment", which "is not *income* in any proper meaning of the term" as hereinafter more fully pointed out. [Emphasis supplied.] Eisner v. Macomber, supra. To the same effect
48 are Towne v. Eisner, supra, and Gibbons v. Mahon, supra.

It is elementary that if it can be done legislation must be construed so as to bring it within the Constitution rather than in conflict with the Constitution. The construction put upon the applicable section of the act by the majority is contrary to the applicable provisions of the Constitution.

If we assume for the purpose of discussion that Congress has power under the Constitution to tax a stock dividend such as we have here there is nothing in the Constitution to make it mandatory upon Congress to do so; Congress has not done so; on the contrary, Congress has expressly exempted such dividend from income tax.

In truth and logic, looking to substance and not to form, and disregarding mere bookkeeping entries, or lack of them or their mechanics, as is done in this dissent, all of the reasoning of the Supreme Court in Eisner v. Macomber, supra, in holding that a common stock dividend on common stock is not income or otherwise taxable, applies with equal force to the preferred stock dividend on common stock with other preferred stock outstanding, in question in these proceedings, and requires a similar result, and is in part set forth in the margin.[11]

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[10] Zellerbach Paper Co. v. Helvering, 293 U. S. 172; Helvering v. Bliss, 293 U. S. 144; Brewster v. Gage, 280 U. S. 227; National Lead Co. v. United States, 252 U. S. 140. 32 B. T. A.

[11] * * * This ["declaring a 'stock dividend'"], however, is no more than a book adjustment, in essence not a dividend but rather the opposite; no part of the assets of the company is separated from the common fund, nothing distributed except paper certificates that evidence an antecedent increase in the value of the stockholder's capital interest resulting from an accumulation of profits by the company, but profits so far absorbed in the business as to render it impracticable to separate them from withdrawal and distribution. In order to make the adjustment, a charge is made against surplus

The Hamilton Manufacturing Co. on June 29, 1929, declared a stock dividend on common stock to the extent of $14 per share
49 payable in its unissued preferred stock of the par value of $100 per share; and it paid the same by issuing such stock on July 1, 1929. This required no distribution of corporate money or other property, but only bookkeeping entries showing the transfer of $261,531.20 (18,680.8×$14) from surplus to preferred stock liability, both on the liability side of the balance sheet, so that the preferred stock liability woud be $977,031.20 with 9,770.312 shares outstanding instead of $715,500 with 7,155 shares outstanding, and the surplus of $444,147.05, after deducting also the July 1, 1929, quarterly preferred stock cash dividend and common stock cash dividend, together totaling $59,221.25, would be reduced to $123,394.60.[12]

It is elementary that the *capital* interest of holders of *common* stock embraces not only the *amount invested*, but also the *surplus*, after all other liabilities, including preferred stock dividends, are provided for. If the dividends payable to holders of preferred stock are paid in cash as they accrue out of surplus available for dividends, as was done in the instant proceedings, then all of the remaining surplus profits constitute *capital* interest of holders of *common* stock only. Hence, when petitioners received the preferred stock as dividends, the outstanding preferred stock having received the dividend to which it was entitled, they merely received the evidence, in the form of preferred stock certificates, of their proportionate share in the surplus to the extent of such dividend. They received nothing in addition to what they theretofore had except such paper.

No money or other property out of corporate earnings or
50 profits accumulated after February 28, 1913, was distributed by the corporation and it merely capitalized a part of its surplus profits on its books of account. Nothing was taken from the

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account with corresponding credit to capital stock account, equal to the proposed "dividend"; the new stock is issued against this and the certificate delivered to the existing stockholders in proportion to their previous holdings. This, however, is merely bookkeeping that does not affect the aggregate assets of the corporation or its outstanding liabilities; it affects only the form, not the essence, of the "liability" acknowledged by the corporation to its own shareholders, and this through a readjustment of accounts on one side of the balance sheet only, increasing capital stock" at the expense of surplus"; it does not alter the preexisting proportionate interest of any stockholder or increase the intrinsic value of the holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of shares, with consequent dilution of the value of each share.

A "stock dividend" shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.

The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment.

We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is the richer because of an increase of his capital at the same time shows he has not realized or received any income in the transaction.

[12] These figures are taken from the record. See illustrative balance sheet and discussion thereof in dissenting opinion in James H. Torrens, 31 B. T. A. 787, 799, 801.

holders of preferred stock. Their capital interest to the extent of the par value of their shares was represented by assets of the corporation and they had no other interest, either capital or income, in the surplus, since they also received their quarterly dividend to which they were entitled on July 1, 1929, when the preferred stock was issued as a dividend on common stock.

These proceedings are distinguishable from *Tillotson Manufacturing Co.*, 27 B. T. A. 913 affirmed in Tillotson Manufacturing Co. v. Commissioner, 76 Fed. (2d) 189, relied upon by the majority.[13]

There is no adequate support in the record in James H. Torrens, 31 B. T. A. 787, also relied upon in the majority opinion, or in these proceedings, for the view that in the Tillotson case a dividend was declared "under substantially similar circumstances." The majority opinion there and here states, in effect, that a converse situation is presented as compared to that in the Tillotson case. This is tantamount to saying that the factual situation in the Tillotson case, as compared with the factual situation there and here, is different. No true stock dividend such as we have here is involved in the Tillotson case. Since the factual situations are thus different, it follows that the Tillotson case is distinguishable from the instant proceedings and the Torrens case upon the facts and in principle.

Furthermore, in the Tillotson case the court stated that "Two tests were thus established for distinguishing a taxable from a non-taxable dividend in stock: (1) Severance of assets from the corporation, and (2) alteration of the preexisting proportionate interest of the stockholders", and that there the first test, but not the second, was met. As appears from the discussion herein, in the instant proceedings both tests are met.

What is said in the Tillotson case, by the Circuit Court of Appeals and the Board, should be read in the light of its peculiar facts and should not be applied to a factual situation such as we have in the instant proceedings, which is so different, and the doctrine of the Tillotson case should not be carried beyond the requirements of the peculiar facts of that case.

51 The issuance of the preferred stock dividend in question here had no effect upon the rights of the preferred stock outstanding. It is elementary that ordinarily the *capital* interest of holders of preferred stock is limited to its par value, and that they have no *capital* interest in the surplus profits; that their interest in the surplus profits is limited to the fixed rate of dividend; that such interest is an *income* interest as distinguished from a *capital* interest; and that even a premium paid to holders of preferred stock upon redemption of such is not a *capital* interest, but constitutes *income* and is taxabale as such. Had the corporation, out of surplus, paid money or other property instead of stock, the assets of the corporation to that extent would have been depleted, but the

[13] The facts of the Tillotson case and the numerous grounds of distinction likewise applicable here are pointed out fully in the dissenting opinion in James H. Torrens, 31 B. T. A. 787, 799.

holders of the preferred stock outstanding could not have rightfully complained. Here the surplus was not distributed in money or other property, out of corporate earnings or profits accumulated after February 28, 1913, but was retained by the corporation. The asset side of the balance sheet was not affected. In fact, the corporation could have distributed the entire surplus to common stockholders in money or other property and the preferred stockholders would have had no right to complain. Even in that event the corporation would still have had assets equivalent to the par value of their stock, and, in addition, assets equal to the value of the amount invested by holders of common stock, which upon dissolution or liquidation is ordinarily subject to the rights of creditors and the preference of preferred stock. The owners of preferred stock previously outstanding were chargeable with knowledge that there was authorized unissued preferred stock which could be sold or issued as a dividend on common stock, as was done here. This must all be viewed in the light of the conditions that existed, in this respect, at the time of the declaration and payment of the stock dividend in question, and not in the light of any imaginary anticipated future changed condition. This question here can not be rightfully tested by different, assumed conditions as of some other time.

None of the Board cases which involve preferred stock dividends, except the Torrens case, are decided upon the *absence* or *existence* of previous outstanding preferred stock. As appears from the discussions herein, both are immaterial. There is nothing in the Constitution, revenue acts, regulations, rulings, or previous court or Board decisions which intimates that if there is preferred stock outstanding at the time of the issuance of a preferred stock
52 dividend such dividend is not a tax-free stock dividend; and all these require a result contrary to that reached by the majority here and in the Torrens case. The Torrens case should be overruled.[14]

It is elementary that fluctuations in value do not give rise to taxable income or deductible losses or constitute additional property rights by virtue of an increase in value; the measure of the value as reflected by the market may change, but the rights to all of the property remain the same whatever its value may be intrinsically or otherwise. The majority opinion does not mention a single thing *in esse*, in being, or of any actual value which the petitioners received from or which was distributed to them by the corporation on July 1, 1929, except the paper upon which the certificates were written. In some respects the majority opinion, in effect, holds taxable a thing *in posse*, that which is not but may be, something dependent upon conditions which can not be foreseen and wholly beyond the control of the corporation or its stockholders. The possibility that the petitioners may or may not receive a greater profit on the preferred stock than they would had they not received

[14] See dissenting opinion in James H. Torrens, 31 B. T. A. 787.

it is treated by the majority as "additional property rights which might well afford them a different and greater market with an increased money return." In Eisner v. Macomber, supra, however, the Court stated that "we regard the market price of the securities as an unsafe criterion and in an inquiry such as the present, *when the question must be*, not what will the *thing sell for, but what is it in truth and in essence.*" [Emphasis supplied.] By the receipt of the preferred stock dividend, the petitioners did not receive *in praesenti* anything in money or in other property, "out of its [corporation's] earnings or profits accumulated after February 28, 1913", as required by section 115 (a) of the 1928 Act, or any "of the company's assets for his [their] separate use and benefit", Eisner v. Macomber, supra, or any "assets of exchangeable and actual value severed from their capital interest" in the company, United States v. Phellis, 257 U. S. 156, or "a thing really different from what he [they] theretofore had", Weiss v. Stearn, 265 U. S. 242; and by a parity of reasoning the petitioners did not even receive any present "rights to the assets" of the company. Their right to future dividends is subject to declaration by the directors and their right to preference as to assets to the extent of the par value of their
53 stock and unpaid dividends, if any, can arise only at the time of liquidation.

The preferred stock received by the petitioners in the instant proceedings is a tax-free true stock dividend.

II

Hence the value of that stock on July 1, 1929, is immaterial.

Furthermore, in reconsidering the memorandum opinion entered herein on June 29, 1933, the Board is considering a new issue raised for the first time by respondent's motions filed July 18, 1933. The only issue raised by the pleadings in these proceedings is whether the preferred stock dividend distributed to the petitioners on July 1, 1929, was later redeemed or canceled by the corporation on October 1, 1929, in such a manner as to make the redemption or cancellation thereof equivalent to the distribution of a taxable dividend within the purview of section 115 (g) of the Revenue Act of 1928. Counsel for respondent so stated at the first hearing. The facts were there stipulated in part and such stipulation treats the dividend of July 1, 1929, as a "stock dividend." Hence the issue there presented did not comprehend the nature and character of the *dividend distributed on July 1, 1929*, but it involved only the nature and character of the *payment made on October 29, 1929*, by the company to the petitioners upon return to the company of the stock dividend distributed on July 1, 1929. This is admitted by counsel for respondent in his argument in support of his motions filed July 18, 1933, wherein he states:

"A stipulation filed with the Board refers to the dividend as a 'stock dividend', and it was on this theory that the deficiencies were determined and the cases presented to the Board."

Hence no question was raised by the parties as to the taxability of the stock dividend of July 1, 1929, until the respondent raised the question in the above motions. It was never raised except by motion and after the proceedings had been disposed of by the decision of June 29, 1933.

The respondent has not indicated that the memorandum opinion filed June 29, 1933, is incorrect in its statement of the issue raised by the pleadings and facts presented. On the contrary, in his brief in support of his motion for consideration and judgment filed
54 July 18, 1933, he stated that "the respondent was not complaining of the Division's decision on the theory on which it was presented and decided but was asking for reconsideration on a new theory" and that the "respondent is content with the findings of fact made by the Board in its previous memorandum Opinion * * *" filed June 29, 1933, except that under his new theory of the proceedings he, for the first time, with his motions, requested a finding as to the value of the preferred stock as of July 1, 1929, without any proof in the record to base such finding upon.

The question whether the stock dividend issued on July 1, 1929, was a tax-free stock dividend constitutes not a "theory", but an issue not raised by the pleadings; and such issue is a wholly different issue, governed by a wholly different statutory provision, section 115 (f) of the 1928 Act and not by section 115 (g) of the 1928 Act. These statutory provisions deal with wholly different causes. As this new issue and cause was not raised in the petition, the duty rested upon the respondent to plead it in his original answer or by amendment thereof under Rule 14 of the Board, which provides that the "answer shall be so drawn as *fully and completely* to advise the petitioner and the Board of the nature of the defense" and "shall contain * * * a statement of any facts upon which the Commissioner relies for defense or affirmative relief." While the question of the correctness of the deficiency is inherent in every proceeding before the Board, the Board, in determining the correctness of the deficiency, will consider only issues raised and causes pleaded (James P. Gossett, 22 B. T. A. 1279; John I. Chipley, 25 B. T. A. 1103; and Claude D. Cass, 32 B. T. A. —— (No. 103). No amendment to the pleadings was filed and the Board erred in ordering further hearing upon an issue and cause not raised by the pleadings. Coosa Land Co., 29 B. T. A. 389, 394; and North American Coal Co., 28 B. T. A. 807, 831. These cases, relied upon by the majority, do not hold that the Board, in determining the correctness of the deficiency, may consider issues or causes other than those raised by the pleadings. Furthermore, as heretofore indicated, all the facts necessary to sustain the respondent's new issue and cause in the instant proceedings were not adduced in evidence at the original hearing and it was necessary to hold a further hearing, after the proceeding had been heard and determined and its memorandum opinion
55 entered, to ascertain the fair market value of the preferred stock as of July 1, 1929.

The rule of the Board requiring the respondent, in his answer, to fully and completely advise the petitioner and the Board of the nature of his defense should not be permitted to be set at naught by designating an issue or a cause as a theory.

Assuming, for the purpose of discussion, that the issue and cause, under section 115 (f) of the 1928 Act, suggested for the first time by respondent's motions, constitutes a mere theory and not an issue or cause, neither the Board nor any Division could rightfully reconsider the memorandum opinion of June 29, 1933, or order the taking of further testimony without a showing on the part of respondent of newly discovered evidence or some other good cause therefor, which is lacking here. Fifth Avenue Bank of New York, Executor, 32 B. T. A. 208; Pierce Oil Corporation, 30 B. T. A. 470; and Fifth Street Building v. Commissioner, —— Fed. (2d) —— (May 13, 1935), affirming 24 B. T. A. 876.

No motion to amend the pleadings or reopen the proceedings to permit the taking of further proof was ever made by the respondent. See Pierce Oil Co., supra.[15]

In the instant proceedings, the hearing was concluded, briefs were filed, and an opinion completely disposing of the proceedings was rendered. All of respondent's motions as made should have been denied.

III

In view of the conclusions heretofore set forth, it is unnecessary to further discuss, directly or indirectly, whether (upon the whole record, under the provisions of the revenue acts[16] construed in the light of the reports of the committees of Congress[17]), (1) after the memorandum opinion had been entered on June 29, 1933, and after respondent's motion, filed July 18, 1933, for review by the Board upon the ground only that such memorandum opinion is contrary to Tillotson Manufacturing Co., 27 B. T. A. 913, was denied by order entered July 24, 1933, and after respondent's motions filed July 18, 1933, for reconsideration of such memorandum opinion and judgment for the respondent, upon the same ground, were denied after hearing thereon by the order entered January 15, 1934, with an accompanying "Memorandum",[18] not a "memorandum

56

[15] The Board there stated: "While Rule 17 does not define the *'conclusion of the hearing', it can not be said to extend beyond the time when the trial has been concluded and the briefs filed.* This we believe is a reasonable rule and fairness and orderly procedure require that it be adhered to in a case such as this. To disregard the rule under such circumstances would be an invitation to litigants to try their cases piecemeal and unreasonably extend the proceedings. Moreover, the petitioners here do not bring themselves within the rule, for the motion before us does not propose to 'amend the pleadings to conform to the proof', but seeks to reopen the case to amend the pleadings, and to offer proof in support of such amendment. * * *

"While the Board has not adopted a rule governing rehearing, its policy in respect thereto is that a rehearing is extraordinary, and *will only be granted on good cause shown.* * * *" [Emphasis supplied.]

[16] Sec. 900, 1924 Act; secs. 1000 and 1005, 1926 Act; secs. 601 and 272 (e), (h), 1928 Act.

[17] Rept. No. 2, Committee on Ways and Means, 70th Cong. 1st sess.; Rept. No. 960, Committee on Finance, 70th Cong., 1st sess.

[18] This "Memorandum" distinguishes the Tillotson case (27 B. T. A. 913) with less elaboration.

opinion", the order of January 31, 1934, should have been entered directing review by the Board of the "Order with the accompanying memorandum", dated January 15, 1934, upon another motion of respondent, based upon the same ground only, filed January 26, 1934, (a) that the Chairman of the Board direct that the "Memorandum Opinion entered by a Division of the Board on January 14, 1934" be reviewed by the Board, and (b) that if the decision of the Division had become the decision of the Board that the Board review its own decision; (2) whether the Board, upon such motion of respondent or upon its own initiative, should have considered the memorandum opinion entered June 29, 1933; (3) whether the Board should have directed another Division of the Board to enter the order dated November 20, 1934, vacating the order entered January 15, 1934, and granting respondent's motion filed January 26, 1934, for reconsideration of the memorandum opinion entered June 29, 1933; (4) whether such other Division should have entered the order dated November 24, 1934, placing these proceedings on the Chicago calendar for hearing evidence upon the subject of the fair market value of the preferred stock of the Hamilton Manufacturing Co., as of July 1, 1929; (5) whether another different Division should have heard such further evidence thereon February 13, 1935; (6) whether the memorandum opinion entered June 29, 1933, has become final so that the time for appeal by respondent has expired; or (7) any other phases of the proceedings.

57 *Conclusion*

In any event, the order of the Chairman dated January 31, 1934, and the orders of November 20 and November 24, 1934, should be vacated and set aside; both motions of respondent filed January 26, 1934, should be denied; the memorandum opinion entered herein on June 29, 1933, as well as the order of the Chairman dated July 24, 1933, and the order dated January 15, 1934, together with its accompanying memorandum, should be permitted to stand; and a decision should be entered in accordance with the memorandum opinion entered therein on June 29, 1933.

Since I presided at the first hearing in these proceedings and at the hearing on two of the three motions of respondent as filed July 18, 1933, and denied the same by the order of January 15, 1934; and, since I made the decision embodied in the memorandum opinion entered June 29, 1933, and dissented from the order entered November 20, 1934, and now dissent from the order of November 24, 1934, as well as from this opinion of the majority, I am constrained to respectfully set forth my views.

Before United States Board of Tax Appeals

(Caption—60890)

Decision

Entered Aug. 9, 1935

Pursuant to the Opinion of the Board promulgated June 27, 1935, the respondent on July 19, 1935, filed a proposed determination and notice of settlement which, after due notice, came on for hearing on August 7, 1935. Petitioner not having contested said proposed determination, it is

Ordered and Decided: That there is a deficiency of $5,831.67 in income tax for the year 1929.

[SEAL] (Signed) EUGENE BLACK, *Member.*

Entered Aug. 9, 1935.

j

58 Before United States Board of Tax Appeals

(Caption—60890)

Notice of Filing Petition for Review

Filed Nov. 8, 1935

To: Robert H. Jackson, Esq., Assistant General Counsel Bureau Internal Revenue, Washington, D. C., Counsel for Commissioner of Internal Revenue, Respondent:

Please Take Notice that the above named petitioner by his undersigned attorney, filed with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., on the 8th day of November, 1935, his petition for review by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of the Board rendered in the above entitled cause. A copy of the petition for review and of the assignments of error as filed with the Board is hereto attached and served upon you.

Dated this 8th day of November, 1935.

Respectfully,

(S) A. L. NASH,
Attorney for Petitioner, H. C. Gowran,
Manitowoc Savings Bank Bldg., Manitowoc, Wisconsin.

ACKNOWLEDGMENT OF SERVICE

Personal service of the foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein,

is hereby acknowledged as having been made on this 8th day of November, 1935.

(S) ROBERT H. JACKSON,
Assistant General Counsel, Bureau of Internal Revenue,
Counsel for Commissioner of Internal Revenue.

59 Before United States Board of Tax Appeals

(Caption—60890)

Petition for review by the United States Circuit Court of Appeals for the Seventh Circuit

Filed Nov. 8, 1935

To the Honorable Judges of the United States Circuit Court of Appeals for the Seventh Circuit:

Now comes H. C. Gowran, petitioner, by A. L. Nash, his attorney, and petitions this Honorable Court for review of the decision of the United States Board of Tax Appeals rendered and entered on August 9, 1935, in cause numbered 60890 on the docket of said Board, wherein the said H. C. Gowran was petitioner and the Commissioner of Internal Revenue was respondent; and in support of this petition respectfully shows this Honorable Court as follows:

I

Venue

The petitioner is an individual and a resident of the judicial circuit of this Honorable Court. The income tax return of the petitioner for the taxable year 1929 was filed in the office of the Collector of Internal Revenue for the District of Wisconsin, which office is, and was at the time said return was filed, located at the city of Milwaukee in the state of Wisconsin, within said judicial circuit.

The respondent is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States. The principal office of said Commissioner of Internal Revenue is located at the city of Washington, D. C.

II

Jurisdiction

The United States Circuit Court of Appeals for the Seventh Circuit has jurisdiction to review the said decision of the United
60 States Board of Tax Appeals by virtue of the provisions of Sections 1001, 1002, and 1003 of the Revenue Act of 1926 as

amended by Section 603 of the Revenue Act of 1928 and as further amended by Sections 1101 and 1102 of the Revenue Act of 1932, and as further amended by Section 519 of the Revenue Act of 1934.

III

Nature of controversy

This is a proceeding for review, by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of the United States Board of Tax Appeals entered on August 9, 1935, sustaining a deficiency in income tax for the calendar year 1929 asserted by the respondent against the petitioner in the sum of $5,831.67.

The said deficiency tax was determined by the respondent and notice thereof was given to the petitioner by respondent's letter dated October 19, 1931, which letter was issued by respondent under the provisions of Section 272 of the Revenue Act of 1928. In said letter the respondent stated that a certain stock dividend received by petitioner during 1929 had been cancelled or redeemed by the issuing corporation at such time and in such manner as to make the distribution and cancellation or redemption essentially equivalent to the distribution to petitioner of a taxable dividend, under the provisions of Section 115 (g) of the Revenue Act of 1928; and that the Commissioner's conclusion was that petitioner thereby had become liable for a deficiency tax in the sum of $5,831.67, based wholly on the distribution and subsequent cancellation or redemption of the stock dividend.

On December 16, 1931, and in accordance with Section 272 of the Revenue Act of 1928, the petitioner filed his petition with the United States Board of Tax Appeals, asking a redetermination of the deficiency determined by the respondent, and in his said petition alleged in substance that in determining petitioner's taxable net income for the calendar year 1929 the respondent has erroneously included therein additional income based on respondent's contention that the distribution and later cancellation or redemption of said dividend shares had been a transaction essentially equivalent to a taxable dividend received by petitioner.

In support of his petition, the petitioner showed the following facts:

61 1. On July 1, 1929, the corporation above mentioned distributed a stock dividend to its common stockholders. The dividend was paid entirely in shares of preferred stock of the corporation computed at the par value of said preferred shares, viz: $100.00 per share.

2. Petitioner received 533 (and a fraction) shares of such preferred stock, at par, as the result of the distribution of this stock dividend.

3. Every other common stockholder of the corporation received the same pro rata distribution of preferred shares, at the same time.

4. No common stockholder had any election, option or right to receive anything except the said preferred shares in payment of the dividend, and there was no representation by the corporation to any stockholder at any time that any part of the dividend shares would ever be redeemed in cash.

5. Petitioner sold his dividend shares to the corporation about three months after distribution of same, at $100.00 per share, the par value of the stock, which was less than the redemption price of same.

6. The transaction last described was not a redemption of its preferred stock by the corporation, but was a purchase of some of its outstanding preferred shares so that the same could be resold to other parties.

On February 5, 1932, the respondent filed with said United States Board of Tax Appeals his answer to the above described petition, by which answer respondent denied that he had committed any error in his conclusion as to the legality and amount of the proposed deficiency tax.

This cause by order of said Board of Tax Appeals was consolidated for hearing and decision with three others, Nos. 60891, 60892, and 60893. After hearing, a memorandum opinion was promulgated by said Board under date of June 29, 1933, holding in favor of petitioner and against the respondent on the issue joined by the original petition and answer, that is to say: holding that the distribution of a stock dividend in preferred shares of the corporation to the petitioner on July 1, 1929, had not been followed by the cancellation or redemption of said shares in such manner as to make the entire transaction the equivalent of a taxable dividend (under the provisions of Section 115 (g) of the Revenue Act of 1928).

On July 24, 1923, respondent's motion for review of the memorandum decision by the entire Board was denied.

62 On January 15, 1934, respondent's motion for reconsideration of the memorandum decision was denied by an order of a Division of the Board.

On January 31, 1934, the Chairman of the Board made an order providing for review by the whole Board of the order which denied respondent's motion for reconsideration.

On November 20, 1934, the Board made an order vacating the order dated January 15, 1934 (which denied respondent's motion for reconsideration) and granting such motion for reconsideration.

On November 24, 1934, an order was made by a Member of the Board whereby the cause was placed on the next circuit calender of the Board of Tax Appeals at Chicago, for hearing evidence limited to the fair market value of the preferred shares distributed to petitioner on July 1, 1929.

Thereafter, at Chicago, it was stipulated that the fair market value of said shares was $100.00 per share, being the same as the par value thereof.

On June 27, 1935, the Board promulgated its decision in this cause and the three other causes consolidated with it. This decision did not change or overrule the prior decision, dated June 29, 1933, whereby it was held that the preferred shares distributed as a dividend had not been redeemed in such a manner as to make the distribution and redemption essentially equivalent to a taxable dividend under Section 115 (g) of the Revehue Act of 1928. But the decision promulgated on June 27, 1935, disclosed that the Board of Tax Appeals now held that the original distribution of the dividend shares by the corporation to petitioner on July 1, 1929, was not a tax-free dividend, but that such distribution constituted taxable income of the petitioner at the time he received said preferred shares from the corporation, and the Board held in its said decision that the receipt by petitioner of said preferred shares constituted income of the petitioner because receipt of said preferred shares resulted in a change in the pre-existing proportionate interest of the stockholder in the corporation.

By its decision promulgated on June 27, 1935, the Board also denied three motions made by petitioner on February 13, 1935, which motions were (1) that the order of the Board dated November 20, 1934, whereby the Board granted reconsideration of its memorandum opinion of June 29, 1933, be vacated and set aside; (2) that respondent's motion for such reconsideration be denied;
63 and (3) that judgment be ordered for the petitioner in accordance with the prayer of his petition. Petitioner's said three motions were made on the ground that the memorandum decision of June 29, 1933, became the decision of the Board of Tax Appeals thirty days thereafter, since within said thirty days said decision was not reviewed by the whole Board, and that no petition for review by the United States Circuit Court of Appeals was filed by respondent within three months after said memorandum decision became the decision of the Board.

IV

Assignments of error

The petitioner says that in the record and proceedings before said United States Board of Tax Appeals, and in the decision and final order of redetermination rendered and entered by said Board in this cause, manifest error occurred and intervened to the prejudice of petitioner, and petitioner assigns the following errors, and each of them, which he avers occurred in the said record, proceedings, decision and final order of redetermination, to-wit:

1. The Board erred in entertaining and granting motions of respondent for reconsideration of the Board's memorandum opinion of June 29, 1933, whereby the issue in the cause then pending had been decided in favor of petitioner; said memorandum opinion having become the decision of the Board on July 29, 1933, and the

respondent not having, within three months thereafter, petitioned for review of such decision by the United States Circuit Court of Appeals.

2. The Board erred in denying petitioner's three motions filed on February 13, 1935.

3. The Board erred in holding that the distribution of preferred shares of Hamilton Manufacturing Company to petitioner on July 1, 1929, by way of stock dividend, was income of the petitioner and taxable as such.

V

Wherefore, being aggrieved by said holdings and conclusions of law contained in and set forth by the opinion of the Board dated June 27, 1935, and by the decision entered pursuant thereto
64 on August 9, 1935, petitioner prays that the decision of said Board be reviewed and reversed and that proper action be taken to the end that the errors complained of may be reviewed and corrected.

A. L. Nash,
A. L. Nash,
Attorney for Petitioner,
Manitowoc Savings Bank Building, Manitowoc, Wisconsin.

[Duly sworn to by A. L. Nash, jurat omitted in printing.]

Before United States Board of Tax Appeals

(Caption—60890)

Order enlarging time

Entered Dec. 26, 1935

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record sur petition for review of
65 the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to February 6, 1936.

(Signed) Eugene Black, *Member.*

Dated: Washington, D. C., Dec. 26, 1935.

jd

Now, February 24, 1936, the foregoing order enlarging time certified from the record as a true copy.

[SEAL] B. D. Gamble,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

(Caption—60890)

Order enlarging time

Entered Feb. 3, 1936

For cause appearing of record, it is

Ordered that the time for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit be and it is hereby extended to March 7, 1936.

(Signed) EUGENE BLACK, *Member.*

Dated: Washington, D. C., Feb. 3, 1936.

s.

Now, February ——, 1936, the foregoing order enlarging time certified from the record as a true copy.

[SEAL] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

66 Before United States Board of Tax Appeals

(Caption—60890)

Praecipe for record

Filed Jan. 22, 1936

To the CLERK OF THE UNITED STATES BOARD OF TAX APPEALS:

You are hereby requested to prepare, certify, and transmit to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, in accordance with the rules of said Court, a transcript of the record in the above entitled proceeding and to include in said transcript of record copies duly certified as correct of the following:

1. Docket entries of all proceedings before this Board.
2. Pleadings before the Board, consisting of the petition and answer thereto.
3. Stipulation of facts signed by counsel for petitioner and respondent and filed with member of Board at Milwaukee on July 26, 1932.
4. Memorandum opinion promulgated June 29, 1933.
5. Motion by respondent filed July 18, 1933, whereby respondent moved for (1) reconsideration of the memorandum opinion entered June 29, 1933, (2) review by the Board of said memorandum opinion and (3) judgment for respondent.
6. Order entered July 24, 1933, denying motion for review of memorandum opinion of June 29, 1933.
7. Order denying respondent's motion for reconsideration of memorandum opinion of June 29, 1933, and denying respondent's motion

for judgment. (This order is dated January 15, 1933, but should be dated January 15, 1934.)

8. Order vacating order of January 15, 1934, and granting respondent's motion for reconsideration, dated November 20, 1934.

9. Motions of petitioner dated February 13, 1935, whereby petitioner moved (1) that the order of November 20, 1934, be vacated, (2) that respondent's motion for reconsideration be denied and (3) that judgment be ordered for petitioner.

10. Stipulation dated February 8, 1935, fixing fair market value of preferred stock of Hamilton Manufacturing Company as of July 1, 1929, signed by counsel for petitioner and respondent.

67 11. Opinion of Board promulgated June 27, 1935, with dissenting opinion by McMahon.

12. Decision of Board entered August 9, 1935.

13. Petition for review and notice of filing thereof with acknowledgment of service, filed by petitioner on November 8, 1935.

14. Board order enlarging time for transmission and delivery of the record, dated December 26, 1935. (Not included in record.)

15. This praecipe with acknowledgment by respondent of service thereof.

(Sgd.) A. L. NASH, *Attorney for Petitioner.*

ACKNOWLEDGMENT OF SERVICE

Service of a copy of the foregoing praecipe on the 18th day of January 1936 is hereby acknowledged.

(Sgd.) HERMAN OLIPHANT,
General Counsel for the Dept. of the Treasury,
Attorney for respondent.

Clerk's certificates to foregoing transcript omitted in printing.]

69 [Caption omitted.]

In United States Circuit Court of Appeals for the Seventh Circuit
No. 5801—October term, A. D. 1935

H. C. GOWRAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of a Decision of the United States Board of Tax Appeals

Motion for leave to file a brief as amicus curiae in opposition to the decision of the United States Board of Tax Appeals

Filed August 31, 1936

Now comes Roger S. Baldwin, an attorney and counsellor duly admitted to practice before the Supreme Court of the United States,

the Circuit Courts of the United States for the Second and Third Circuits, and the highest courts of the States of New York and of Connecticut, and represents that there is involved in this case the question of the proper interpretation of the provisions of the applicable Revenue Acts of the United States that "a stock dividend shall not be subject to tax." There are also involved the question as to whether or not the type of stock dividend present in this case is taxable as income under the 16th Amendment to
70 the Constitution of the United States and, if this Court should hold that the stock dividends involved are exempt from taxation, there is also involved the proper basis to use in determining the gain or loss from the sale or other disposition of the stock so received as a stock dividend.

These questions vitally affect the interests of three taxpayers who are clients of the undersigned, who are now involved in a controversy with the Treasury Department as to whether or not certain stock dividends received by them are subject to income taxation. The dividends in question, both in connection with such controversy and with this case, were paid in preferred stock on common stock. The United States Board of Tax Appeals has recently held in this and similar cases that such dividends are taxable. The tentative liability against the three taxpayers above referred to may amount to as much as $6,000,000. The decision and opinion in this case may determine the question of the taxability of such stock dividends.

As set forth in the attached affidavit of the undersigned, duly sworn to on the 26th day of August 1936, copies of the proposed brief will be furnished to Mr. A. L. Nash, the attorney for the Petitioner herein, and to the Honorable Robert H. Jackson, Assistant Attorney-General of the United States, attorney for the Respondent. Both attorneys have given their consent in writing to the filing by the undersigned of a brief amicus curiae herein. The letters of both attorneys signifying their consents are annexed to such affidavit.

The undersigned has not been admitted to practice before this Court, but will personally appear and request admission on or before the day on which this case is heard.

Therefore, he prays leave to file as amicus curiae a brief in opposition to the decision of the United States Board of Tax Appeals herein.

Respectfully submitted,

ROGER S. BALDWIN,
120 Broadway, New York, New York.

Dated, August 26, 1936.

71 In United States Circuit Court of Appeals

[Title omitted.]

Affidavit Supporting Motion for Leave to File Brief as Amicus Curiae

Filed Aug. 31, 1936

STATE OF NEW YORK,
County of New York, ss:

Roger S. Baldwin, having duly sworn, says that he was duly admitted and qualified on June 8, 1914, as an attorney and counsellor of the Supreme Court of the United States, on September 20, 1899, as an attorney of the Circuit Court of the United States for the Southern District of New York in the Second Circuit, on March 3, 1902, as an attorney and counsellor of the Circuit Court of the United States in the District of New Jersey in the Third Circuit, on November 8, 1897, as an attorney and counsellor at law of all the courts of the State of New York, including the highest court, of such state, and on January 31, 1919, as an attorney at the Bar of the several courts, including the highest court, of the State of Connecticut.

The undersigned proposes to move this Court for leave to file in this case a brief as amicus curiae in opposition to the decision of the United States Board of Tax Appeals which was in favor of the Respondent.

Copies of the brief which he proposed to file will be filed in this Court and will be furnished to the attorneys for the Petitioner and for the Respondent herein on or before September 10, 1936.

The attorneys for the Petitioner and for the Respondent herein have consented to the filing of such a brief by the undersigned. The letters containing such consents are annexed hereto, namely a letter, of Honorable Robert H. Jackson, Assistant Attorney-General of the United States, dated July 31, 1936, and a letter of A. L. Nash, Esquire, dated August 14, 1936.

ROGER S. BALDWIN.

72 Sworn to before me this 26th day of August, 1936.

[SEAL] M. Philip,
M. PHILIP,
Notary Public, Kings County.

Kings Co. Clk.'s No. 247, Reg. No. 7032. N. Y. Co. Clk.'s No. 65, Reg. No. 7 P 45.

Commission expires March 30, 1937.

In United States Circuit Court of Appeals

[Title omitted.]

Order granting leave to file brief as amicus curiae

August 31, 1936

It is ordered that Roger S. Baldwin be granted leave to file a brief in this cause as amicus curiae on or before September 10, 1936.

In United States Circuit Court of Appeals

[Title omitted.]

Motion for permission to file brief as amici curiae

Filed Nov. 18, 1936

73 Now come Allin H. Pierce, a member of the Bar of this Court, and Will R. Gregg, a member of the Bar of the State of New York, and move that the Court grant them permission to file a brief in this proceeding as amici curiae.

In support of their motion the undersigned say:

1. One of the issues involved in this case is the proper construction of section 115 (f) of the Revenue Act of 1928. That issue is one of importance and great public interest. The provisions of said statute have been incorporated in the Revenue Acts applicable to all years from 1921 to 1935 inclusive and the Court's decision in the case will involve the validity of numerous regulations and rulings of the Treasury Department promulgated over that period. The decision will affect both individuals and corporations.

2. The brief, which the undersigned ask leave to file as amici curiae, is confined to a discussion of the aforesaid issue. Particular attention has been given to recent developments which provide assistance in construing the aforesaid statute, i. e., the revised provisions of the Revenue Act of 1936 (approved June 22, 1936), and a recent decision of the Board of Tax Appeals (promulgated October 21, 1936).

3. The undersigned are attorneys for taxpayers who have cases pending before the United States Bureau of Internal Revenue, which involve facts similar to those in the present case, and which may be vitally affected by the decision in this case.

4. A copy of this motion and a copy of the brief, which the undersigned ask leave to file as amici curiae, have been delivered to the attorneys for each of the parties to this proceeding.

Wherefore the undersigned request that the Court grant them permission to file their brief in this cause as amici curiae.

ALLIN H. PIERCE,
WILL R. GREGG,
2 Wall Street, New York, New York.

November 18, 1936.

* * * * * * *

74 In United States Circuit Court of Appeals

[Title omitted.]

Order granting leave to file brief as amici curiae

November 18, 1936

It is ordered by the Court that Allin H. Pierce and Will R. Gregg be granted leave to file a brief in this cause as amici curiae.

In United States Circuit Court of Appeals

[Title omitted.]

Minute entry—November 18, 1936

Now this day come the parties by their counsel, and this cause comes on to be heard on the printed record and briefs of counsel, and on oral argument by Mr. A. L. Nash, counsel for petitioner, and by Mr. Morton K. Rothschild, counsel for respondent, and the Court having heard the same takes this matter under advisement.

* * * * * * *

75 In the United States Circuit Court of Appeals for the Seventh Circuit

No. 5801—October Term and Session, 1936

H. C. GOWRAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals

Opinion

Filed December 22, 1936

Before EVANS, Circuit Judge, and LINDLEY and BRIGGLE, District Judges.

LINDLEY, District Judge. Petitioner seeks a review of a decision of the Board of Tax Appeals approving respondent's assessment of a deficiency income tax against the petitioner for the year 1929.

Throughout 1929 petitioner was a holder of common stock in the Hamilton Manufacturing Company. On July 1st of that year, the corporation declared a dividend on the common stock of $14 per share and paid the same by distribution of shares of the corporation's preferred stock, at the par value of $100 per share. As his

dividend, petitioner received 533 shares. Previously he had held only common stock. At the time the dividend was declared the corporate earned surplus was $440,000, against which the total dividend, $261,531.00, representing 2,615 shares of preferred stock at $100, was charged.

Some three months after receiving the preferred stock, petitioner sold it to the corporation, at $100 per share. Petitioner, in filing his income tax return, apportioned a part of
76 the cost of his common stock to the preferred, treating the cost of the common as the total cost of both, and paid a tax on this basis. The commissioner assessed a deficiency tax, upon the premise that the completed transaction was essentially a cancellation or redemption of the preferred stock, equivalent to the distribution of a taxable dividend.

Petitioner filed his petition with the Board of Tax Appeals to set aside the commissioner's determination. The commissioner answered and, under date of June 29, 1933, a division of the board promulgated a memorandum opinion in favor of petitioner and against respondent, holding that the transaction did not amount to cancellation or redemption.

On July 16, 1933, respondent filed with the Board his motions for (1) reconsideration of the memorandum opinion, (2) review by the Board, as provided by Section 906 (d) of the Revenue Act of 1924, as amended by Section 1000 of the Revenue Act of 1926, and (3) judgment in favor of respondent. On July 24, 1933, respondent's motion for review was denied. On January 15, 1934, his motions for reconsideration of the memorandum opinion and for judgment were denied by Division 16. On January 26, 1934, respondent moved for review of the order denying respondent's motions for reconsideration and judgment, and five days later, the Board granted the review. Still later, on November 20, 1934, it disapproved the former order and granted respondent's motion for reconsideration of the memorandum opinion of June 29, 1933.

On February 13, 1935, petitioner filed with the Board three motions: (1) that the order of the Board dated November 20, 1934, whereby the Board granted reconsideration of the memorandum opinion of June 29, 1933, be vacated; (2) that respondent's motion for such reconsideration be denied; and (3) that judgment be entered for petitioner in accordance with the prayer of his petition for redetermination. On June 27, 1935, the Board delivered another decision. The opinion of the majority did not overrule the conclusions reached June 29, 1933, wherein it was held that the preferred shares had not been redeemed in such manner as to make the transaction essentially equivalent to a taxable dividend, but held that the original distribution was not a tax-free stock dividend, but consti-
tuted taxable income, because of the fact that the issue of the
77 shares resulted in a change in the proportionate corporate interests of the stockholders. The Board at that time denied petitioner's three motions made on February 13, 1935.

On August 9, 1935, the Board entered the decision from which this appeal is taken, approving the deficiency of $5,831.67 in income tax for the year 1929.

The facts are not disputed. The only questions submitted are those of law.

It is contended that the Board was without jurisdiction to decide the case upon a point not urged by the commissioner. The Board approved the commissioner's assessment but did so upon a legal theory different from his. We are of the opinion that the Board acted within its powers. It had a right to grant a rehearing. Washburn Wire Co. v. Commissioner, 67 F. (2d) 658 (CCA8); Helvering v. Continental Oil Co., 68 F. (2d) 750 (App. D. C.); Griffiths v. Commissioner, 50 F. (2d) 782; Bankers Coal Co. v. Burnet, 287 U. S. 308, 313; Burnet v. Lexington Ice & Coal Co., 62 F. (2d) 906 (CCA4); Helvering v. Louis, 77 F. (2d) 386 (App. D. C.). There was no abuse of discretion in doing so, for the Board may uphold the commissioner's decision for a different reason from that set up by the latter in his deficiency notice. This rule is particularly applicable where there is no dispute as to the facts. It is immaterial whether the commissioner proceeded upon the wrong theory. The burden is upon petitioner to show that the assessment is wrong, upon any proper theory; otherwise he must fail. Crowell v. Commissioner, 62 F. (2d) 51 (CCA6); Beaumont v. Helvering, 73 F. (2d) 110 (App. D. C.); J. & O. Altschul Tobacco Co. v. Commissioner, 42 F. (2d) 609 (CCA5).

No injury accrued to petitioner in this respect, as the stipulated facts covered all facts, including a value of $100 per share for the prefered stock. Consequently, there was no surprise of or advantage over petitioner.

The next question confronting us is the character of the distribution. Since the decision of the Board the Supreme Court on May 18, 1936, decided Koshland v. Commissioner, 298 U. S. 441, and there held that the issuance of common stock as a dividend upon preferred stock is a stock dividend which may be taxed; that where a stock dividend gives the stockholder an interest different in character from that which his former holdings represented, he receives taxable income.

In its previous holdings, Eisner v. Macomber, 252 U. S. 189,
78 and Towne v. Eisner, 245 U. S. 418, the Supreme Court had said that a common stock dividend did not in any wise alter the interest of a common stockholder. In the Koshland decision the court pointed out that a different result occurs when a different kind of stock is issued as a dividend. The legal quality of what the taxpayer has after such distribution, is different from that which he had before. Therefore, the distribution is one of property rights of variant character from those which he previously owned, and as such, therefore, constitutes income which could be taxed. The court, however, did not decide whether Congress has in fact levied a tax upon such kind of stock dividend. That question is now presented.

The Revenue Act of 1928, c. 852, 45 Stat. 791, expressly provides that stock dividends shall not be subject to tax, and the regulations have at all times, since said date, provided that the issuance of its own stock by a corporation as a dividend does not result in taxable income. This statute was enacted by Congress and the regulations of the Department were promulgated after the Supreme Court decided that dividends of common stock to common stockholders do not constitute income. Since that decision, it has been the settled policy in legislation and administration to make no assessment against such distribution as income. Since the Koshland decision, however, it is clear that there are two kinds of stock dividends—those which result in no change of interest in the corporate property and those which result in a new sort of interest. The latter is income and may be taxed.

But we find in the act nothing which will justify us in reading into it any implied intent upon the part of Congress to limit the term "stock dividend." Rather, we believe that it had not previously occurred to Congress that there are two kinds of stock dividend, one taxable and one not. This is confirmed by the fact that in 1936 Congress amended the act so as to make taxable such stock dividends as are taxable within the constitutional amendment. To say that Congress intended so to provide by prior legislation seems to us unjustified.

The situation then is this: A stockholder received in 1929 a stock dividend which might have been taxed if Congress had seen fit to do so. This Congress had not done. Consequently, petitioner received his preferred stock free of any tax. Upon its receipt, it became an asset of his estate. Thereafter within the same year, he sold
79 it. Consequently, he was bound to account for any profit realized in the sale. Such profit is taxed, and he must account for the same.

The material question is as to his cost basis for the determination of such profit. Petitioner urges that it is $100, the stipulated value at the time he received it. The government says it is zero.

We liken the receipt of the tax-free income in the present case to that of a tax-free gift, bequest, legacy or other tax-free addition to the taxpayer's estate. One who receives a tax-free gift and later sells it, in the absence of statute providing otherwise, is taxed upon the profit arising from the difference in its value at the time he receives it and the sale price. Similarly one who receives a tax-free bequest, when selling it, is taxed upon the profit arising from any excess of the sale price over its fair market value at the time of receipt. The measure of liability of the taxpayer here is to be determined by the same standard; his tax, in case of sale, is to be computed just as if the dividend had not been tax-free. He must account for any difference between the stipulated value of $100 and the selling price. If this property were added to his estate by inheritance, and if there were no laws taxing it, upon sale of the same, under the established

policy of the revenue laws of the United States, a tax would be assessed upon any profit resulting from a sale in excess of its value at the time he received it. The same yard-stick must apply here.

Consequently, the sale of the stock having been for the same amount as the fair cash market value at the time he received it, no profit resulted, and no tax liability exists. The decision of the Board of Tax Appeals is reversed with directions to proceed in conformity with this opinion.

80 In United States Circuit Court of Appeals

H. C. GOWRAN

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Decision of the United States Board of Tax Appeals

Judgment

December 22, 1936

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the decision entered in this cause on August 9, 1935, by the United States Board of Tax Appeals, be and the same is hereby reversed and that this cause be and the same is hereby remanded to the said United States Board of Tax Appeals with directions to proceed in conformity with the opinion of this Court.

Recital as to petition for rehearing

And afterwards, to-wit: on the eleventh day of January 1937, there was filed in the office of the Clerk of this Court a petition for a rehearing, which said petition for a rehearing is not copied here.

81 In United States Circuit Court of Appeals

[Title omitted.]

Order denying petition for rehearing

Jan. 12, 1937

It is ordered by the Court that the petition for rehearing in this cause be, and the same is hereby denied.

Recital as to issuance of mandate

And afterwards, to-wit: on the ninth day of February 1937, the mandate of this Court issued to the United States Board of Tax Appeals.

82 [Clerk's certificate to foregoing transcript omitted in printing.]

83 Supreme Court of the United States

Order allowing certiorari

Filed May 17, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 41,427. U. S. Circuit Court of Appeals, Seventh Circuit. Term No. 27. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* H. C. Gowran. Petition for a writ of certiorari and exhibit thereto. Filed April 12, 1937. Term No. 27 O. T. 1937.

U. S. GOVERNMENT PRINTING OFFICE: 1937